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**BEFORE THE ARIZONA CORPORATION COMMISSION**

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MARC SPITZER, Chairman
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| IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN | Docket No. T-01051B-03-0454 |
| IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS | Docket No. T-00000D-00-0672<br>**NOTICE OF FILING DIRECT TESTIMONY** |

Staff hereby provides Notice of Filing its Direct Testimony in this docket. An original and fifteen copies are submitted of the Direct Testimony of Elijah Abinah, Matthew Rowell, Armando Fimbres, Joel Reiker, Alejandro Ramirez, Del Smith, Michael L. Brosch, Steven C. Carver, William Dunkel and Thomas Reagan.

Copies of the confidential and/or highly confidential versions of the Direct Testimony of Matthew Rowell, Armando Fimbres, Michael L. Brosch, Steven C. Carver, William Dunkel and Thomas Regan are being provided to the Commissioners and their aides, the presiding Administrative Law Judge and those parties who have executed and docketed Exhibits A and/or B to the Protective Order in this proceeding.

RESPECTFULLY SUBMITTED this 18th day of November 2004.

Arizona Corporation Commission
DOCKETED
NOV 18 2004
DOCKETED BY

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**DIRECT
TESTIMONY**

**OF**

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MATTHEW ROWELL
ARMANDO FIMBRES
DEL SMITH
JOEL M. REIKER
ALEJANDRO RAMIREZ**

**DOCKET NOS. T-01051B-03-0454
T-00000D-00-0672**

**IN THE MATTER OF QWEST CORPORATION'S
FILING OF RENEWED PRICE REGULATION PLAN
AND
THE INVESTIGATION OF THE COST
OF TELECOMMUNICATIONS ACCESS**

**NOVEMBER 18, 2004**

# ABINAH

**BEFORE THE ARIZONA CORPORATION COMMISSION**

MARC SPITZER
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

| | |
|---|---|
| IN THE MATTER OF QWEST CORPORATION'S FILING AMENDED RENEWED PRICE REGULATION PLAN ) | DOCKET NO. T-01051B-03-0454 |
| IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS ) | DOCKET NO. T-00000D-00-0672 |

**PREFILED TESTIMONY OF**

**ELIJAH O. ABINAH**

**FOR THE**

**ARIZONA CORPORATION COMMISSION**

**UTILITIES DIVISION**

**November 18, 2004**

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## EXECUTIVE SUMMARY

Staff is recommending continuation of the current Price Cap Plan with the modifications discussed in Mr. Rowell's testimony. In its filing to renew its Price Cap Plan, Qwest proposed substantial modifications to the Plan's terms and conditions. Staff is not opposed to many of the proposed modifications, as long as additional safeguards are adopted and put in place by the Commission.

Staff also believes it is appropriate for the Plan to recognize the changing competitive conditions in Qwest's service territory, and where warranted, to allow Qwest additional pricing flexibility. More specifically, while Staff can not recommend approval of Qwest's Competitive Zone proposal as set forth in the Qwest's testimony, Staff is not opposed to the use of Competitive Zones as long as the designation is made pursuant to R14-2-1108 and some added safeguards are in place.

Staff is requesting that the designation of competitive zones be done in a separate proceeding for primarily three reasons. First, Staff believes that in order to make this designation under R14-2-1108 additional market share information and determinations are necessary. Second, there are problems with the existing data which need to be resolved. Third, Qwest does not want to assume carrier of last result obligation ("COLR") in competitive zones and Staff believes this is a critical issue which must be resolved before competitive zones are established. Qwest supports addressing COLR in a separate proceeding.

Staff Witness' Brosch and Carvers' review of Qwest's R14-2-103 filing indicates that the Company's revenue deficiency is approximately $3.5 million. Staff recommends that the revenue caps be adjusted to recognize this deficiency as well as Staff's proposed reduction to access charges.

An analysis of Qwest's service quality reports indicates that Qwest's performance has improved significantly in some areas throughout the initial term of the Price Cap Plan. Thus the Price Cap Plan has not acted as a disincentive to Qwest to take measures to improve service quality.

Finally, Qwest has not met the criteria in the Commission's rules for Arizona Universal Service Fund ("AUSF") support and a cost/revenue analysis of providing local exchange service does not support Qwest's request for funding from the AUSF at this time.

## INTRODUCTION

**Q. Please state your name and business address.**

A. My name is Elijah O. Abinah. My business address is 1200 West Washington Phoenix Arizona, 85007.

**Q. Where are you employed and in what capacity?**

A. I am employed by the Utilities Division ("Staff") of the Arizona Corporation Commission ("ACC" or "Commission") as the Assistant Director.

**Q. How long have you been employed with the Utilities Division?**

A. I have been employed with the Utilities Division since January 2003.

**Q. Please describe your educational background and experience.**

A. I received a Bachelor of Science degree in Accounting from the University of Central Oklahoma in Edmond, Oklahoma. I also received a Master of Management degree from Southern Nazarene University in Bethany, Oklahoma. Prior to my employment with the ACC, I was employed by the Oklahoma Corporation Commission for approximately eight and a half years in various capacities in the Telecommunications Division.

**Q. What are your current Responsibilities?**

A. As the Assistant Director, I review submissions that are filed with the Commission and make policy recommendations to the Director regarding those filings.

## PURPOSE

**Q. What is the purpose of your testimony in the current Docket Nos. T-01051B-03-0454 and T-00000D-00-0672, the Application of Qwest Corporation ("Qwest" or "Company") for a renewed Price Cap Plan and the investigation into Qwest's Access Charges.**

A. The purpose of my testimony is to provide the Commission with an overview and explanation of Staff's position in this case including Staff's review of Qwest's application for its renewed Price Cap Plan ("Plan"), Staff's review of Qwest's R14-2-103 filing as ordered by the Commission including its proposal with respect to access charges and Staff's recommendations regarding Qwest's request.

**Q. Please begin by providing the names of the Staff witnesses and the subject of their testimony.**

A. Please see the chart below:

| Witness | Staff/Consultant | Topic |
|---|---|---|
| Elijah Abinah | Staff | Overview and Explanation of the Staff Position |
| Matthew Rowell | Staff | Recommended Changes To The Current Price Regulation Plan |
| Armando Fimbres | Staff | The Competitive Situation In Qwest's Service Area |
| Del Smith | Staff | Qwest's Service Quality |
| Joel Reiker | Staff | Cost of Equity |
| Alejandro Ramirez | Staff | Capital Structure, Cost of Debt and Overall Rate of Return |
| Steven Carver | Utilitech | Review and Evaluation of Elements of Rate Base and Operating Income Included in the Overall Revenue Requirement |
| Michael Brosch | Utilitech | Accounting Adjustments To Qwest's R14-2-103 Filing |
| William Dunkel | William Dunkel & Associates | Depreciation Rates, Digital Subscriber Line Service Construction Charges, and Reproduction Cost New Less Depreciation |
| Thomas Regan | William Dunkel & Associates | Access Charges and Arizona Universal Service Fund |

## BACKGROUND

**Q. Please provide a brief background of this case.**

A. Yes: Pursuant to Commission Decision No. 63487, Qwest filed a renewed Price

Regulation Plan. By Procedural Order dated November 17, 2003, the ALJ ordered that the Access Charge Proceeding be bifurcated into two phases, with Phase 1 addressing Qwest's Access charges in conjunction with the review of its current Price Cap Plan in Docket No. T -01051B -03-0454.

On November 7, 2003, Qwest filed a motion to clarify, or on the alternative, to terminate the Price Cap Plan. On Page 2, lines 1-6, of its filing, Qwest asked that in the absence of a Commission Order adopting Qwest's interpretation of the Price Cap Plan the Commission enter an Order declaring that the Price Cap Plan terminate as of March 30, 2004. Entry of such an Order, according to Qwest, would return Qwest to the traditional rate of return regulation that applied to it prior to the adoption of the Plan, and continue Qwest's rates at the levels existing at the termination of the Plan.

On February 10, 2004, in Decision No. 66772, as clarified by Decision No. 67047, dated June18, 2004, the Commission denied Qwest's request as inconsistent with the express terms of the Plan and required Qwest to provide the information required under A.A.C.R14-2-103.

On May 20, 2004, Qwest made its R14-2-103 filing with the Commission.

**Q. Can you briefly summarize the current Price Cap Plan?**

A. Yes. In Decision No. 63487, issued on March 30, 2001, the Commission approved an alternative form of regulation ("AFOR") plan for Qwest. The Plan classified Qwest's services into three Baskets:

- Basket 1: Basic/Essential Non-Competitive Services
- Basket 2: Wholesale Services
- Basket 3: Flexibly-Priced Competitive Services

**Basket 1**

The weighted average price level ("Price Index") of all services contained in Basket 1 is capped using an annual inflation/productivity adjustment factor (described in detail below.) On an annual basis Qwest was required to adjust prices in Basket 1 to account for the effect of the inflation/productivity adjustment. Prices for many services could be adjusted up or down with 30 days notice (but increases were capped at 25% per year.) Certain basic services in Basket 1 have "hard caps," that is, their prices can not increase (but they can decrease.) Individual service prices must exceed Total Service Long Run Incremental Cost ("TSLRIC") and comply with the imputation requirements of A.A.C. R14-2-1310(C).

**Basket 2**

Basket 2 contains wholesale services such as access charges, PAL lines, and Unbundled Network Elements ("UNEs.") Many of these services are governed by their own specific pricing rules and those rules continued during the term of the Plan. Intrastate switched access rates decreased by $5 million per year during the initial term of the plan.

**Basket 3**

Basket 3 includes services that have been accorded pricing flexibility or have been determined to be competitive under A.A.C. R14-2-1108. The Basket 3 price cap index was set at the existing revenue level for Basket 3 services plus 13.4% increased by $5 million a year to account for the access charge reductions. New services could be placed in Basket 3, however, the Commission could require a different classification if its review of the filing warranted this treatment. New services are filed as tariff filings. Packages of services from Basket 1 and Basket 3 need to be filed for review by Staff, pursuant to A.A.C. R14-2-1108.

The price of a Basket 3 service or service package must exceed the TSLRIC of the service or package and comply with the imputation requirements of A.A.C. R14-2-1310(C).

## QWEST'S PROPOSED MODIFICATIONS

**Q. Can you please briefly summarize Qwest's proposed modifications to the Price Cap Plan?**

A. Yes. Qwest is requesting continuation of the Plan that was approved by the Commission in Decision No. 63487, with the following major modifications:

1) Elimination of the productivity/inflation adjustment mechanism;
2) Replacement of an indexed basket cap on the Basic/Essential Service basket with newly determined revenue cap;
3) Introduction of a "Competitive Zone" test for moving services out of the Basic/Essential Services Basket on a geographic basis;
4) Ability to move wholesales services to a competitive sub-basket within Basket 2;
5) Elimination of the revenue cap on the Competitive Services basket;
6) Greater flexibility for services in the Competitive Services Basket comparable to that enjoyed by Qwest's competitors; and
7) Also Qwest requests the opportunity to earn a fair return on its investment, making appropriate prospective adjustment in light of results observed during the initial term of the price cap plan regulation.

**Q. What additional relief did the Company request?**

A. In Mr. Ziegler's testimony, Qwest also requested the following:

1) Elimination of distance sensitive zone charges in retail Zones 1 and 2;
2) Request to use the Arizona Universal Service Fund ("AUSF") as a mechanism to

increase competition in the less –densely populated portions of Qwest's service territory

3) Hold the issue of intrastate access charges in abeyance pending action by the FCC in its intercarrier compensation docket.

4) Elimination of the one free call allowance for directory assistance services.

In addition, in Mr. McIntyre's testimony, the Company is requesting that the Commission deregulate Billing and Collection services. Qwest has also renewed its request that Voice Mail be deregulated.

**Q. What are Staff's recommendations?**

A. Staff recommends that the Commission approve Qwest's request to renew its Price Cap Plan subject to the modifications discussed in Mr. Rowell's testimony. Staff also recommends adjustment of the revenue cap on Basket 3 of the Plan consistent with the findings of Staff Witnesses Brosch, Carver, Regan, Dunkel, and Rowell.

**Q. Based on Staff's review of Qwest's Application, does Staff agree with all the modifications proposed by Qwest?**

A. No. Staff is not opposed to some of Qwest's requests and Staff is recommending approval of those modifications. In other instances, Staff does not agree with Qwest's proposals as presented but is willing to support the proposed modifications requested by the Company, with changes. In several instances, the Staff does not support Qwest's proposals.

Basically, Staff's collective testimonies support the following modifications proposed by Qwest:

1. Elimination of the productivity/inflation factor;

2. Competitive Zone Designation as set forth in Mr. Rowell's testimony;
3. Deregulation of Voicemail and Billing and Collection services;
4. Use of a Revenue Cap on Basket 1 service;
5. Qwest's Proposal for Promotional Offering/Tariff Filings; and
6. Flexibility for Qwest to bundle and package services and their inclusion in Basket 3.

Staff does not support:

1. Elimination of the one Free Directory Assistance Call;
2. Qwest's Request for AUSF Support of $64 million;
3. An end user surcharge to recover lost revenue associated with any access charge reduction; and
4. Elimination of the Revenue Cap on Basket 3.

**Q. Does Staff have any additional recommendations?**

A. Yes. Staff recommends that the revenue cap on Basket 3 be adjusted as described in Mr. Rowell's testimony.

**Q. Please compare and contrast Qwest's proposal to Staff's recommendation.**

A. Please see the table below.

| Qwest's Initial Proposals | Staff Recommendations |
|---|---|
| Elimination of the productivity/inflation adjustment mechanism | Staff agrees. |
| Replacement of an indexed basket cap on the Basic/Essential Service basket with newly determined revenue cap | Staff agrees. |

| | |
|---|---|
| Introduction of a "Competitive Zone" test for moving services out of the Basic/Essential Services Basket on a geographic basis | Staff agrees with the concept. |
| Ability to move wholesales services to a competitive sub-basket within Basket 2 | This request does not appear in Qwest's revised filing. Staff has assumed that Qwest is no longer pursuing this proposal. |
| Elimination of the revenue cap on the Competitive Services basket | Staff disagrees |
| Opportunity to earn fair return on its investment, making appropriate prospective adjustment in light of results observed during the initial term of the price cap plan regulation | Staff agrees |
| **Additional Qwest Proposals** | **Staff Recommendations** |
| Elimination of distance sensitive zone charges in retail Zones 1 and 2 | Staff disagrees. |
| Request to use the Arizona Universal Service Fund ("AUSF") as a mechanism to increase competition in the less –densely populated portions of Qwest's service territory | Staff disagrees. |
| Hold the issue of intrastate access charges in abeyance pending action by the FCC in its intercarrier compensation docket. | Staff disagrees. |
| Elimination of the one free call allowance for directory assistance services | Staff disagrees. |
| **Qwest Deregulation Proposals** | **Staff Recommendations** |
| Deregulation of Billing and Collection Services | Staff agrees. |
| Deregulation of Voice Mail Service | Staff agrees. |

## REVENUE DEFICIENCY AND NEED FOR R14-2-103 INFORMATION

**Q. Why does Staff believe that a review of Section R14-2-103 information was appropriate?**

A. Based on Qwest's pre-filed testimony and accompanying schedules that were filed in this Docket, Qwest contends that its revenue deficiency on its original cost rate base amounts to $318.5 million and $458.8 million on its fair value rate base. Staff believes that it was necessary to examine and verify the magnitude of the deficiency claimed by Qwest. The analysis performed by Staff was not only for the customer's benefit but for Qwest's as well. Staff's analysis allowed it to determine whether Qwest is earning a fair return and to ensure that Qwest's customers will be charged just and reasonable rates. Staff found as a result of its own independent examination that the Company has a revenue deficiency of $3.5 million.

Qwest was claiming a very large revenue deficiency and asked in its initial filing for an opportunity to earn a fair return on its investment. Qwest also made it clear, in its motion to clarify, its intention to revert back to traditional rate base/rate of return regulation if the Commission did not agree to the modifications it is requesting to the Plan. Therefore, in such circumstances, it was critical that the Commission have the benefit of an independent analysis performed by Staff before rendering its determination in this case.

**Q. What is the relationship between the R14-2-103 filing and the changes proposed by Qwest?**

A. A R14-2-103 filing is the equivalent of the traditional Rate Base/Rate of Return filing. Given the Arizona Constitution and current interpretations of its provisions by the Arizona Courts, it is necessary to consider this information in settling the revenue caps of the Plan. Under the Arizona Constitution, the Commission must ensure that Qwest's rates are just and reasonable. A utility in Arizona is entitled to an opportunity to earn a fair return on the fair value if its properties devoted to the public use, no more and no less. To ensure this, the Price Cap's three Baskets are tied to the revenue requirement determined by traditional methods.

**Q. On page 7 lines 2-3 of Mr. Ziegler's Direct Testimony, he asks about the relationship between R14-2-103 and Qwest's proposals in this Docket. Do you agree with Mr. Ziegler's response to that question?**

A. No. Staff believes a Section R14-2-103 filing is directly related to Qwest's filing. It was agreed to by all the parties that access charges and rates may not be reduced or increased outside the context of a rate proceeding unless, at a minimum, a revenue neutral-mechanism is developed. Further, Qwest, as part of its filing, is asking for "the opportunity to earn a fair return on its investment, making appropriate prospective adjustment in light of the results observed during the initial term of the price regulation plan." Thus, unless Qwest's numbers were to be accepted at face value, it was necessary to obtain, review and analyze the information required under an R14-2-103 filing.

**Q. On page 3 lines 17-19 of Mr. Ziegler's Testimony, he stated that "although the Rule 103 filing shows a revenue requirement deficiency of $322 million, Qwest does not propose rate increase to recover the revenue requirement". Does Staff agree with that statement?**

A. No. Although Qwest may not be directly seeking to recover the revenue deficiency, Qwest is seeking to recover $64 million from the Arizona Universal Service Fund, which amounts to an indirect rate increase as well as miscellaneous increases of several million dollars. In addition, by according Qwest additional pricing flexibility and eliminating the cap on Basket

3 as requested by Qwest, Qwest would be at liberty to adjust its rates for different services at will.

**Q. What did Staff's review of Qwest's R14-2-103 filing reveal?**

A. According to Staff Witness Brosch's testimony, Qwest's actual revenue deficiency is only $3.5 million. In arriving at this amount, Staff attempted to be extremely fair to Qwest. Staff added several adjustments not proposed by Qwest which actually increased the revenue requirement. A large part of the reduction to Qwest's declared revenue deficiency relates to Staff's proposal to adjust Qwest's depreciation rates. As Staff Witness Dunkel explains, the depreciation rates for some of Qwest's largest technology accounts were set at accelerated levels in the last Qwest depreciation case based on Qwest's assertions that it was planning to undertake a significant modernization effort by replacing much of its copper facilities with fiber. This did not occur nor is it part of Qwest's construction plans for the foreseeable future. Consequently, an adjustment to these rates was appropriate. However, to be fair to Qwest, Staff is proposing use of the midpoint of the current FCC ranges, and has ensured that the new rates are consistent with the rates authorized for Qwest by other states in its 14 state region.

## PRICE CAP PLAN

**Q. Why is Staff not recommending that the Company revert back to traditional rate base rate of return regulation?**

A. Based on the nature of the market, Staff believes that the most appropriate form of regulation of Qwest is for the Commission to renew the Plan that was approved in the 2001 settlement, with the modifications discussed in Staff Witness Rowell's testimony.

**Q. What are the reasons for Staff's recommendation to continue the current Price Cap Plan with modifications?**

A. Staff believes that in today's telecommunications market, an alternative form of regulation other than the traditional rate base rate of return regulation is appropriate. Staff Witness Rowell addresses the benefits of alternative regulation in his testimony.

Staff recognizes that in the telecommunications industry today, consumers have options available to them when it comes to the provision of telephone services. As stated in Mr. Rowell's testimony, alternative forms of regulation were implemented to increase the incentive for utilities to provide services more efficiently. Staff believes that by approving Qwest's request for renewal of the Plan with the modifications proposed by Staff will incent the Company to provide services in a more efficient manner that might lead to lower costs of service, which should lead to lower rate to its customers.

**Q. Does Staff believe granting Qwest's request for renewal of the Plan with Staff's proposed modifications is in the public interest?**

A. Yes. Staff believes that if the safeguards and added criteria recommended by Staff are put in place, then granting Qwest's request for Competitive Zones is in the public interest. As stated in Mr. Rowell's testimony, the prices for basic services in Basket one will be capped. Qwest can only lower its rates in that Basket. Staff also believes that, by granting Qwest's request for renewal of the Plan, Qwest will be able to respond in a timely manner to end users' needs and potentially have the ability to deploy new technology and innovative offering. Also, Staff believes that Staff's proposals will allow Qwest to earn a fair return on their investment. Staff's proposal at the same time ensures that customers' rates are just and reasonable.

**Q. Based on your understanding of the Plan, are there any provisions that preclude the Commission or the Staff from reviewing other forms of regulation or additional changes to Qwest's Plan?**

A. No. Section 6 (c) of the Plan, states "Nothing herein shall affect the Commission's jurisdiction or authority to determine the most appropriate form of regulation for Qwest at the end of the three year term of the Price Cap Plan, including termination of the Plan."

## COMPETITIVE ZONE DESIGNATION

**Q. Should the Commission adopt Qwest's Competitive Zone Proposal?**

A. The Commission should only adopt Qwest's Competitive Zone Proposal if the modifications proposed by Staff Witness Rowell are adopted. As stated in Mr. Rowell's testimony, Staff is not opposed to the idea of Competitive Zone Designation, Staff's recommendation will be to utilize the zip code as the geographic areas for such designation. Staff also believes that the designation of specific competitive zones should be done in separate dockets.

**Q. Have any other Commissions utilized zip codes as the geographic area of analysis?**

A. It is my understanding that the FCC has utilized zip codes to review where broadband deployment has occurred.

**Q. Why is Staff recommending a separate docket to address Qwest's request for Competitive Zone Designation?**

A. Staff is recommending a separate docket to address Qwest's Request for Competitive Zone Designation because of the following reasons:

1) Staff believes the issue of carrier of last resort ("COLR") needs to be resolved prior to such designations.

2) Staff believes that R14-2-1108 at the minimum should be the criteria used for designation of Competitive Zones. Staff believes that the same criteria should apply whether the Commission is designating an area as competitive or declassifying an area as non-competitive.

3) R14-2-1108 lists market share as one criterion for competitive classification. However, a particular market share level that meets the criteria needs to be established.

## AUSF

**Q. What are staff's recommendations regarding Qwest's request for Arizona Universal Service Funds?**

A. Staff cannot support Qwest's request.

**Q. Please explain Qwest's request.**

A. Qwest's proposal is to eliminate existing zone charges to consumers, by adopting the Commission's UNE zone de-averaging scheme. Qwest sought AUSF support to make up the difference between current and cost-based rates, in the higher cost areas so they will be relieved of covering the direct cost of providing services and the cost will be spread over all of those paying into AUSF.

**Q. Should Qwest's request be considered a request to deploy DSL or broadband?**

A. No. Based on the information provided by Qwest in their application, Qwest will not utilize the fund to deploy DSL or broadband. As a matter of fact, Staff believes this would simply be an additional revenue stream for the Company.

**Q. Has Qwest demonstrated to Staff how it will address the rural subscribers issue, such as broadband deployment?**

A. No. Qwest has made no commitment with respect to the rural areas in its service territory.

**Q. What are the benefits to Competitive Zones?**

A. Competitive Zone Designation would allow Qwest more pricing flexibility if the level of competition in the geographic area selected justified this designation. As discussed in Staff Witness Rowell's testimony, if a geographic area is designated as competitive, the services for which competitive designation are approved would move to Basket 3.

**Q. Do competitive conditions within Qwest's service territory support this type of additional pricing flexibility for Qwest?**

A. Based on Staff's findings, Qwest is still the dominant provider in the local exchange markets within its service territories.

Staff Witness Fimbres' testimony indicates that while the local market is still highly concentrated, competition has a foothold in some business markets. The degree of competition in residential markets is a more difficult determination given recent developments at the federal level. Mr. Rowell's testimony indicates that given developments at the federal level, the market for traditional residential wireline service is likely to be a duopoly with Cox Arizona Telecom, L.L.C. left as the only CLEC serving significant numbers of residential customers. Nonetheless, there is a trend as noted in Staff's testimonies of both access line decline and associated revenue decline, which must be attributed at least in part to competition. Thus, the additional flexibility afforded by the Price Cap Plan is appropriate to address increased competition where warranted. However, because the R14-2-1108 criteria ere not all satisfied by Qwest, and problems with the underlying data exist as discussed by Mr. Fimbres, Staff is recommending separate Competitive Classification proceedings to determine which areas of Qwest's service territory warrant Competitive Zone classification in the future.

**Q. How have recent actions at the federal level affected competition in Arizona?**

A. Recent court decisions such as the United States Court of Appeals for the District of Columbia Circuit's ("D.C. Circuit") decision in *United States Telecom Association v. FCC*, 359 F.3d 554 (D.C. Cir. 2004) ("USTA II") and FCC decisions have reduced the ability of competitors to compete using Unbundled Network Element-Platform ("UNE-P") and the ability of Competitive Local Exchange Companies ("CLECs") to lease the wide band portion of the loop or fiber facilities.

**Q How does Staff address these developments in its testimony?**

A. First, Staff Witness Rowell points out that the residential market use of the Unbundled Network Element-Loop ("UNE-L") is almost nonexistent. The FCC found in its Triennial Review Order ("TRO") that Incumbent Local Exchange Companies "(ILECs") cannot handle the volume of UNE-L conversions necessary to serve the mass market. Therefore, Staff is recommending that Qwest be ordered as part of this case to revive the collaborative Batch Hot Cut Process.

Second, in recognition of federal decisions which no longer require the ILECs to lease or make available the wideband portion of the loop in many instances, the Commission could require Qwest to submit its plans for broadband deployment in rural areas on an annual basis including areas where it has determined that deployment would not be economically feasible. One of the reasons for the FCC action was to encourage broadband deployment by ILECs. Thus, it is reasonable that the Commission examine the Company's Plans especially in rural areas, where the incentive to deploy advanced services may not be as great.

## RATE DESIGN ISSUES

### SWITCHED ACCESS CHARGES

**Q. What is Qwest's position as it relates to switched access charges?**

A. On page 14 lines 22-23 and page 15 lines 1-7 of Mr. McIntyre's testimony, he states that Qwest is not proposing any changes for switched access at this time because of the sweeping changes to the entire intercarrier compensation issue being considered at the FCC and the industry. The FCC has taken extensive comments and is likely to make its position known in the future. The result according to Qwest may well be a completely different structure for revenue collection that could change the state role in regulating this revenue.

**Q. Does Staff agree with Qwest?**

A. No. Staff believes that this Commission has jurisdiction over intrastate access charges and that the Commission should not delay until proceedings at the FCC are concluded. The proceedings at the FCC may take some time to resolve, thus, the Commission should proceed to address the issues at this time.

**Q. What is Qwest's position as it relates to any access charge reduction by the Commission?**

A. On page 15 lines 22-23 and page 16 lines 1-3 of Mr. McIntyre's testimony, he states "...in that case, Qwest will ask the Commission to provide a plan on how to recover the revenue currently provided by switched access. If for example, intrastate switched access rates are reduced to the interstate level and the revenue recovery is shifted to residential rate payers, the impact will be a rate increase of about $1.00 per residential access line."

**Q. What is Staff's recommendation regarding access charge reduction at this time?**

A. Staff recommends the intrastate access charges be reduced by $8.9 million as proposed by Staff Witness Regan, for the reasons given in Mr. Regan's testimony.

**Q. Is Staff opposed to Qwest recovering its access charge revenue loss?**

A. No. Staff believes that Qwest should be able to recover the revenue loss due to any access charge reductions.

**Q. Does Staff support use of an end-user surcharge to recover this revenue loss?**

A. No. Staff believes that the current methodology utilized under the Plan is more appropriate. Today, Qwest is allowed to recover its access charge revenue reduction in the form of an increase to the Basket 3 Revenue Cap.

## FREE CALL ALLOWANCE TO DIRECTORY ASSISTANCE

**Q. What is Qwest's position as it relates to the free call allowance for directory assistance?**

A. Qwest is proposing to eliminate the free call allowance for directory assistance.

**Q. What is Staff's position?**

A. Staff cannot support this request. Dex usually prints and issues, yellow pages or white pages once a year. The publication may occur when an end user is in the process of moving, thus sometimes an end user's name might not appear in the directory. Staff believes that this is a benefit to the end users.

**CONSUMER BENEFITS**

**Q. What benefits does the consumer receive under the Plan as modified?**

A. Staff is proposing hard caps on basic service rates whether they are contained in Basket 1 or Basket 3 at existing rate levels. Competitive Zone Designation may result in lower basic rates for some consumers where the degree of competition warrants this added flexibility. Staff has proposed several changes to Qwest's Service Quality Tariff to ensure continued improvement by Qwest in this area as well.

**Q. What are Special Rural Construction Charges and when do these charges apply?**

A. Section 4.2.2 of Qwest's Exchange and Network Services Price Cap Tariff describes when these charges apply and how they are determined. Generally, these charges apply to new establishments of service outside the exchange base rate area when the rural customer's pro rata share of the cost of constructing facilities exceeds $3,000.

**Q. So the $3,000 represents that portion of the pro rata construction cost that the Company is responsible for?**

A. Yes. The $3,000 allowance makes service more affordable for many rural customers and is intended to strike a reasonable balance in keeping rural construction charges as affordable as possible without over burdening the general body of rate payers with these costs.

**Q. Did Staff collect any data regarding the amount of these types of charges collected from customers in its review of the Price Cap Plan?**

A. Yes data was collected on the construction charges Qwest collected from customers in 2001, 2002 and 2003 in Staff Data Request WDA 04-023.

**Q. Was Staff able to draw any conclusions from this data?**

A. Only that the level of these contributions declined significantly in 2003. The data included contributions for other types of construction so no specific conclusions regarding Special Rural Construction could be made only that contributions in general had declined.

**Q. Could the decline mean that less rural customers were able to get service in 2003?**

A. If fewer rural customers can afford to pay the applicable construction charge, I would expect the level of contributions to decline.

**Q. Have telephone plant construction costs increased significantly since the $3,000 allowance was established?**

A. I understand that the $3,000 allowance was established in the late 70s early 80s time frame so I think it is safe to conclude that there has been a significant increase in these types of construction costs.

**Q. In your opinion is it reasonable to conclude that a larger percentage of these construction costs are being assessed to the rural customer versus when the $3,000 allowance was established 20 years ago?**

A. While Staff did not conduct any studies to compare rural construction costs 20 years ago with today's costs, I think we can assume that the rural customer is probably paying a higher percentage of these costs today than back when the allowance was first established.

**Q. Does Staff have any recommendations to make regarding the $3,000 construction allowance?**

A. Yes. Staff recommends that the $3,000 allowance be increased to $5,000.

**Q. Why does staff believe that $5,000 is a reasonable allowance?**

A. In response to Staff Data Request WDA 15-001 Qwest estimated that the annual revenue impact of this change would be $202,000, that is, contributions would be reduced by $202,000. Qwest should be allowed to recover the $202,000 in an appropriate manner. Qwest went on to estimate that 115 customers who would have exceeded the $3,000 allowance and incurred a construction charge would not exceed a $5,000 allowance. Staff's experience has been that many of the applicants who live in the more remote areas where the construction charges are greater can afford to pay little if any construction charge. Therefore, this could equate to 115 rural customers getting service who without the increased allowance couldn't afford telephone service. Staff believes its proposal strikes a reasonable balance that is fair to all Qwest customers.

## SUMMARY OF STAFF'S RECOMMENDATIONS

**Q. Please summarize Staff's recommendations.**

A. Staff recommends the following:

(1) Continuation of the Price Cap Plan that was approved in 2001 with the modifications discussed in Staff's testimonies:

(2) Elimination of the productivity/inflation adjustment mechanism factor;

(3) Replacement of an indexed basket cap on the Basic/Essential Service basket with a newly determined revenue cap;

(4) Designation of Competitive Zones as long as the safeguards and criteria discussed by Staff Witness Rowell are incorporated;

(5) Deregulation of Voicemail and Billing and Collection service as requested by Qwest;

Staff does not recommend the following:

(1) Granting Qwest AUSF;

(2) Eliminating the one free call allowance for Directory Assistance;

(3) Imposing any end-user surcharge to recover lost revenues due to a reduction in access charges; and

(4) Eliminating the revenue cap in Basket 3 services.

Staff also recommends that the Commission adjust the revenue cap in Basket 3.

**Q. Does this conclude you direct testimony?**

A. Yes, it does. However, Staff reserves the right to supplement its testimony based upon subsequent filings in this docket.

# ROWELL

**BEFORE THE ARIZONA CORPORATION COMMISSION**

MARC SPITZER
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

| | |
|---|---|
| IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN. | DOCKET NO. T-01051b-03-0454 |
| IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS. | DOCKET NO. T-00000D-00-0672 |

DIRECT

TESTIMONY

OF

MATTHEW ROWELL

CHIEF ECONOMIST

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

NOVEMBER 18, 2004

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## Executive Summary

My testimony explains Staff's recommendations concerning the changes Qwest has proposed to its Price Regulation Plan.

Qwest has proposed elimination of the inflation/productivity factor as part of a revised plan. Staff supports the proposed elimination of the inflation/productivity factor. Qwest has proposed the elimination of the revenue cap on Basket 3 services. Staff does not support elimination of the Basket 3 revenue cap. Qwest has proposed that all packages be treated as Basket 3 services. Staff supports treating all Packages as Basket 3 services with certain restrictions. Qwest has proposed that all new services be treated as Basket 3 services automatically. Staff does not support treating all new services as Basket 3 services automatically.

Qwest has proposed the concept of Competitive Zones whereby Qwest will have significant pricing flexibility in certain geographic areas. Staff supports the concept of Competitive Zones but can not support the specific proposal that Qwest has offered. Staff offers an alternative Competitive Zone proposal.

Qwest has proposed that Voicemail services and Billing and Collection services be deregulated. Staff supports deregulation of these services. Qwest has proposed alterations to its Promotional tariffs that Staff also supports.

My Testimony addresses the competitive aspects of Qwest's proposal to receive AUSF support. (Staff Witness Thomas Regan presents Staff's primary recommendation on Qwest's AUSF proposal.

My Testimony also contains a discussion of the competitive situation in the Arizona telecommunications market and contains recommendations relevant to competition.

I. Introduction

**Q. Please state your name and business address for the record.**

A. My name is Matthew Rowell. My business address is: Arizona Corporation Commission, 1200 W. Washington St., Phoenix, Arizona 85007.

**Q. What is your position at the commission?**

A. I am the Chief of the Telecommunications and Energy section of the Commission's Utilities Division.

**Q. Please describe your education and professional background.**

A. I received a BS degree in economics from Florida State University in 1992. I spent the following four years doing graduate work in economics at Arizona State University where I received a MS degree and successfully completed all course work and exams necessary for a Ph.D. My specialized fields of study were Industrial Organization and Statistics. Prior to my Commission employment I was employed as a lecturer in economics at Arizona State University, as a statistical analyst for Hughes Technical Services, and as a consulting research analyst at the Arizona Department of Transportation. I was hired by the Commission in October of 1996 as an Economist II. I was promoted to the position of Senior Rate Analyst in November of 1997 and to Chief Economist in July of 2001. In my current position I am responsible for supervising nine professionals who work on a variety of telecommunications and energy matters.

**Q. What is the purpose of your testimony?**

A. My testimony will explain Staff's recommendations regarding Qwest Corporation's ("Qwest") filing for a renewed price regulation plan. Specifically my testimony will address the changes to Qwest's current price regulation plan that Staff recommends.

**Q. Please summarize the provisions of Qwest's current price regulation plan.**

A. In Decision No. 63487 (March 30, 2001) the Commission approved an alternative form of regulation ("AFOR") plan for Qwest. The AFOR divided Qwest services in to three baskets:

- Basket 1: Basic/Essential Non-Competitive Services
- Basket 2: Wholesale Services
- Basket 3: Flexibly-Priced Competitive Services

**Basket 1**

The weighted average price level ("Price Index") of all services contained in Basket 1 is capped using an annual inflation/productivity adjustment factor (described in detail below.) On an annual basis Qwest adjusted prices in Basket 1 to account for the effect of the inflation/productivity adjustment. Prices for many services could be adjusted up or down with 30 days notice (but increases were capped at 25% per year.) Certain basic services in Basket 1 have "hard caps," that is, their prices can not increase (but they can decrease.) Individual service prices must exceed Total Service Long Run Incremental Cost ("TSLRIC") and comply with the imputation requirements of A.A.C. R14-2-1310(C).

**Basket 2**

Basket 2 contains wholesale services such as access charges, PAL lines, and Unbundled Network Elements ("UNEs.") Many of these services are governed by their own specific pricing rules and those rules continued during the term of the AFOR. Intrastate switched access rates were to reduce by $5 million per year during the initial term of the plan.

**Basket 3**

Basket 3 includes services that have been accorded pricing flexibility or have been determined to be competitive under A.A.C. R14-2-1108. The Basket 3 price cap index was set at the then existing revenues from Basket 3 services plus 13.4% and was adjusted upwards by $5 million a year to account for the access charge reductions. New services could be placed in Basket 3, however, the Commission can require a different classification. New services are filed as tariff filings. Packages of services from Basket 1 and Basket 3 need to be filed for review by Staff, pursuant to A.A.C. R14-2-1108. The price of a Basket 3 service or service package must exceed the TSLRIC of the service or package and comply with the imputation requirements of A.A.C. R14-2-1310(C).

**Q. What changes has Qwest requested to its Price Regulation plan in its May 20, 2004 filing?**

A. Qwest is proposing five basic changes to the AFOR.[1] First, Qwest proposes to eliminate the inflation/productivity adjustment factor for the cap on Basket 1.

Second, Qwest is proposing a slight downward adjustment in the Basket 1 Price Index Cap and elimination of the zone charges for basic service in retail Zones 1 ($1.00) and 2 ($2.00.)

Third, Qwest is proposing a Competitive Zone plan, whereby it would be allowed additional pricing flexibility within certain geographic areas that are determined to be competitive.

Fourth, Qwest proposes to eliminate the revenue cap[2] on Basket 3.

Fifth, Qwest proposes that any new services should automatically be considered Basket 3 services and that its promotional offerings be subject to the same conditions as its competitors.

[1] In its original filing Qwest had also proposed a sub-basket in Basket 2 for competitive wholesale services. However, that request does not appear in Qwest's revised filing so Staff is assuming the company is no longer pursuing it.
[2] Note that "revenue cap" and "price cap index" are synonymous.

## II. The Inflation/Productivity Adjustment Factor and the Price Regulation Plan

**1. Overview of the various types of alternative forms of regulation ("AFORs").**

**Q. Why have Federal and State Commissions implemented alternative forms of regulation ("AFORs")?**

A. Some commissions have recognized that traditional rate base rate of return ("ROR") regulation created an environment that did not provide incentives for utility companies to operate in the most efficient manner. Because ROR provided the utility with its costs and a return on investment, some experts contend that it was possible that the utility would over-invest in plant and equipment in order to increase its earnings. Alternative forms of regulation were implemented to increase the incentive for utilities to provide their services more efficiently.

**Q. What types of AFORs have been implemented for telecommunications companies?**

A. AFORs that have been implemented include indexed price cap plans, price cap plans, rate freezes, price cap plans with earnings sharing, and price cap plans with revenue sharing.

**Q. What is a pure price cap plan?**

A. A pure price cap plan is one where there are no changes to the maximum rates that a company can charge during the term or the plan. Under this type of plan, any revenues and earnings are limited only by the company's ability to generate revenues and profits. Pure price cap plans are essentially the same as rate freezes.

**Q. Did Commissions modify pure price cap plans when they were initially introduced?**

A. Yes. Because price cap plans were untested, Commissions modified pure price cap plans in order to prevent unexpected results. The modifications most Commissions adopted were the implementation of earnings sharing and revenue sharing.

**Q. Please describe an indexed price cap plan.**

A. An indexed price cap plan is one where rates for individual services or groups of services may change by an amount that results from the application of a formula. The formula that is used may include such items as an adjustment to the cap that is based on changes in the rate of inflation, a measure of the expected productivity gain, and changes outside the utility's control. The current price cap plan for Basket 1 services in Arizona can be described as an indexed price cap plan.

**Q. Please describe earnings sharing.**

A. Under an earnings sharing regime, no change to a company's rates are made if the earnings fall between a range above and below the target rate of return (sometimes called the dead band). In some instances, returns above the upper limit of the dead band are returned to ratepayers in the form of payments or credits. In addition, a return level was generally specified beyond which all earnings are returned to ratepayers. Rate adjustments may have been included that allowed for increases in rates if earnings fell below certain levels. Since an earnings sharing plan requires that a company's earnings be periodically verified, such plans have been characterized as administratively burdensome.

**Q. What is a revenue cap plan?**

A. A revenue cap plan is similar to a price cap plan. The difference is that instead of capping prices for services or groups of services, revenues for service are limited. The cap may be adjusted to account for such things as customer growth, changes in inflation and productivity. Qwest's Basket 3 services in Arizona are essentially under a pure revenue cap.

**Q. How is earnings sharing different from revenue sharing?**

A. With earnings sharing, earnings above a certain level are returned, in whole or in part, to ratepayers. In a revenue sharing plan, revenues above a certain level are returned in whole or in part to ratepayers. The issues associated with verifying whether the company did or did not experience positive earnings levels are avoided with a revenue sharing approach.

**Q. Do you have any information on the evolution of AFORs?**

A. Yes. Table 1 is informative. It shows the number of states that adopted AFORs over the past two decades.

**Table 1 Number of States with:**

| Year | Rate of return regulation | Rate case moratoria | Earnings sharing regulation | Price Cap Regulation | Other |
|---|---|---|---|---|---|
| **1985** | **50** | **0** | **0** | **0** | **0** |
| **1986** | **45** | **5** | **0** | **0** | **0** |
| **1987** | **36** | **10** | **3** | **0** | **1** |
| **1988** | **35** | **10** | **4** | **0** | **1** |
| **1989** | **31** | **10** | **8** | **0** | **1** |
| **1990** | **25** | **9** | **14** | **1** | **1** |
| **1991** | **21** | **8** | **19** | **1** | **1** |
| **1992** | **20** | **6** | **20** | **3** | **1** |
| **1993** | **19** | **5** | **22** | **3** | **1** |
| **1994** | **22** | **2** | **19** | **6** | **1** |
| **1995** | **20** | **3** | **17** | **9** | **1** |
| **1996** | **15** | **4** | **5** | **25** | **1** |
| **1997** | **13** | **4** | **4** | **28** | **1** |
| **1998** | **14** | **3** | **2** | **30** | **1** |
| **1999** | **12** | **1** | **1** | **35** | **1** |
| **2000** | **8** | **1** | **1** | **39** | **1** |
| **2001** | **7** | **1** | **1** | **40** | **1** |
| **2002** | **8** | **1** | **1** | **38** | **2** |
| **Source:** | **Sappington, David E. M., "The Effects of Incentive Regulation of Retail Telephone Service Quality in the United States," Review of Network Economics, Vol. 2, Issue 4, December 2003, pp. 355 - 375.** | | | | |

**2. The inflation/productivity adjustment factor**

**Q. What was the purpose of the inflation/productivity factor?**

A. The purpose of the inflation/productivity factor was to provide an incentive for Qwest to provide service more efficiently and at the same time to prevent Qwest from reaping excessive benefits had the AFOR not worked as expected.

**Q. What is the current price cap formula for Basket 1 Services?**

A. The current formula for the Price Cap Index for Basket 1 is:

$$1.00 + \%\Delta\text{GDP-PI} - \text{X-Factor} \geq [\text{SUM } [P_N * Q_b]] / [\text{SUM } [P_q * Q_b]]$$

The left side of the above formula is the inflation/productivity adjustment factor. Essentially, it is inflation minus productivity. The change in GDP-PI (Gross Domestic Product Price Index) is an accepted measure of inflation and the X-factor is an estimate of annual productivity increases. The right side of the formula is the Price Cap Index. The numerator of the Price Cap Index is the sum of the proposed/new prices multiplied by the "base year" quantities of demand. Where price changes have not occurred the base year prices are used. The denominator is the sum of the base year prices multiplied by the "base year" quantities of demand.

**Q. What was the rationale for including each of the price cap formula components?**

A. GDP-PI is included as a measure of inflation that is intended to allow for real prices of services to remain constant over the term of the plan. This factor allows Qwest to change prices so that it can at least keep up with inflation. The X-Factor is an estimate of the change in productivity that can be expected over the term of the plan. This component provides Qwest with an incentive to make productivity gains that are greater than the estimated "normal" gain. If Qwest is able to exceed the normal productivity gains, it is able to retain those earnings for itself.

**Q. What value was assigned to the X-Factor in the Settlement agreement that was approved by the Commission?**

A. The X-Factor in the Settlement Agreement is 4.2 percent.

**Q. Who establishes the GDP-PI?**

A. GDP-PI is produced by the U.S. Department of Commerce, Bureau of Economic Analysis.

**Q. What were the effects of the productivity factor on Qwest's revenues during the term of the plan?**

A. Table 2 shows the revenue effects of the productivity factor and how it was calculated:

**Table 2**

| Date | %ΔGDP-PI | Productivity Offset % | Adjustment % | Revenue Effect |
|---|---|---|---|---|

| | | | | |
|---|---|---|---|---|
| April 2002 | 2.348 | - 4.2 | - 1.852 | -$14.391M |
| April 2003 | 0.764 | - 4.2 | - 3.4358 | -$28.321M |
| April 2004 | 1.678 | - 4.2 | - 2.5222 | -$18.318M |

**Q. Are there any limitations on how price adjustments can be made as a result of the application of the formula?**

A. Yes. Certain of the Basket 1 services have been "hard capped" meaning that even if the application of the formula results in a net increase in revenues for Basket 1, the rates for these services will not increase. These services are flat rate residential; flat rate business; 2- & 4-party service; exchange zone increment charges; low use option service; service stations service; telephone assistance programs; individual PBX trunks, including features; toll blocking; 900/976 blocking and basic listing service. In addition, prices for the remainder of the services included in Basket 1 may not increase by more than 25 percent in any one plan year.

**Q. How is this different from other price cap plans that have been implemented?**

A. Most Price Cap Plans do not currently include a hard cap and a productivity offset for retail service rates.

**Q. Have you reviewed any information on the use of price indices and productivity offsets in other states' Price cap plans?**

A. Yes. I reviewed the Commission Orders for Utah, New Mexico, Washington and Oregon. In addition, I reviewed information provided by the National Regulatory Research Institute and the State Telephone Regulation Report.

**Q. For states in Qwest's RBOC region, what is the current regulatory treatment for services equivalent to those included in Basket 1?**

A. Table 3 provides information on the current regulatory treatment of Basket 1 services in other Qwest states:

**Table 3**

| State | 2003 | 2004 |
|---|---|---|
| **CO** | NI PC | NI PC |
| **ID** | Dereg, NI PC or RoR | Dereg, NI PC or RoR |
| **IA** | I PC | I PC |
| **MN** | NI PC | NI PC |
| **MT** | RoR | RoR |
| **NE** | N R | N R |
| **NM** | NI PC | NI PC |
| **ND** | NI PC | NI PC |
| **OR** | R F | R F |
| **SD** | NI PC | Dereg |
| **UT** | I PC | I PC |
| **WA** | RoR | RoR |
| **WY** | NI PC | Dereg or N R |

Where:
NI PC - Non-Indexed Price Cap
I PC - Indexed Price Cap
RoR - Rate of Return Regulation
N R - Rates not Reviewed
R F - Rate Freeze
Dereg - Deregulated

**Q. What is the prevalence of the use of inflation/productivity adjustment factors in state price cap plans?**

A In the Qwest states, only Iowa and Utah include a productivity offset in their price cap formulas. Iowa's productivity offset is 2.6% while Utah's is 4.95%. In total twelve of the fifty states employ inflation/productivity adjustment factors. Table 4 shows the states that have inflation/productivity adjustment factors and the value for the X-factor (or productivity offset) in each state:

**Table 4**

| State | X-Factor |
|---|---|
| **Utah** | 4.95% |
| **Arizona** | 4.2% |
| **Delaware** | 3% |
| **Illinois** | 3% |

| | |
|---|---|
| **Wisconsin** | 3% |
| **Iowa** | 2.6% |
| **Kansas** | 2.3% |
| **Tennessee** | 2%[3] |
| **Michigan** | 2% |
| **North Carolina** | 2% |
| **Florida** | 1% |
| **Maryland** | 3 year average of CPI |

Source: State Telephone Regulation Report, July 30, 2004; August 13, 2004; and August 27, 2004

Besides the states listed above there are several states that have an inflation adjustment factor without any productivity offset. That is, the price cap is indexed to the percent change in the GDP-PI (or some fraction of it) without any adjustment.

Q. **Is Staff aware of any Arizona utility besides Qwest that is subject to an inflation/productivity adjustment factor?**

A. No.

Q. **What was the basis for the current inflation/productivity factor?**

A. The current inflation/productivity factor was the result of settlement negotiations.

Q. **What is Qwest's proposal with respect to the inflation/productivity adjustment factor?**

A. Qwest proposes to eliminate the inflation/productivity adjustment factor.

Q. **Are circumstances sufficiently different today such that Qwest's proposal regarding the elimination of the inflation/productivity adjustment factor is justifiable?**

A. Yes. At the time that the initial price cap plan was implemented, Qwest had been operating in an environment where it had limited competition and little incentive to increase its efficiency in the provision of services. In addition, Qwest was not subject to competition in its core business to the extent that it is today. Staff's analysis of Qwest's financial and competitive information suggests that Qwest is losing lines and revenues as a

[3] Actual index formula for Tennessee is the lesser of one-half of GDP-PI or GDP-PI minus 2%.

result of that competition. Given the line and revenue losses that Qwest has experienced recently Staff does not believe a productivity adjustment is appropriate. In an environment where revenues are growing a productivity adjustment may be appropriate to provide incentives to the company to operate efficiently. However, in an environment where revenues are declining imposing such incentives should not be necessary.

**Q. What did the Commission have to say about the inflation/productivity adjustment factor in the Decision that approved implementation of the price cap plan?**

A. In Decision No. 63487, beginning page 10, line 27, the Commission indicated that if the Commission finds at the end of the initial three year term of the plan that Qwest has enjoyed greater productivity gains than it has in the past the productivity factor could be adjusted.

**Q. What is your recommendation on Qwest's proposal to eliminate the productivity offset?**

A. Staff recommends that the Commission not include a productivity offset in a renewed Price Regulation Plan for Qwest.

**3. Revenue Cap on Basket 3**

**Q. What is Qwest's rational for eliminating the revenue cap on Basket 3?**

A. Qwest argues that the prices in Basket 3 are effectively constrained by competition and therefore no revenue cap is necessary.[4]

**Q. What is Staff's recommendation on eliminating the cap on Basket 3?**

A. Staff does not support eliminating the revenue cap on Basket 3 due to fair value considerations. Since Qwest still has a mix of both competitive and noncompetitive service offerings, Staff believes the revenue cap serves an important purpose under existing case law. This issue will be addressed fully in Staff's legal briefs.

**Q. What is Staff's recommendation regarding the revenue cap on Basket 3?**

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[4] Ziegler p. 10, lines 21- 22.

A. Staff witness Mike Brosch testifies that Qwest is currently experiencing a revenue deficiency of $3.53 million. Also, Staff witness Thomas Regan testifies that the rate design changes recommended by Staff will result in a reduction in Qwest's revenue of $7,193,350. This reduction is mainly due to a reduction in Access Charges of $8.9 million.[5] In light of that, Staff believes it is appropriate to increase the revenue cap on Basket 3 by $10,723,350 ($3,530,000+ 7,193,350.) Additionally, the Basket 3 and Basket 1 revenue caps should also be adjusted to account for the services and service packages that are moved from Basket 1 to Basket 3. The final revenue caps on Baskets 1 and 3 should be determined during the compliance phase of this case when it will be know which Baskets will contain which services.

**4. Qwest's Proposals Regarding New Services and Packages**

**Q. Please explain Qwest's proposals regarding new services and packages.**

A. Qwest proposes that service packages that contain both Basket 1 and Basket 3 services be considered Basket 3 services without the A.C.C. R14-2-1108 review that is now required. Qwest also recommends that all new services be considered Basket 3 services.[6]

**Q. What consumer harm may occur if Qwest is allowed to automatically package Basket 1 and Basket 3 services?**

A. Since the prices of Basket 3 services are flexible, consumers may end up paying more for a package of services than they would if they purchased the services separately. In order to protect consumers from this eventuality Staff recommends that a hard cap be placed on any packages that contain Basket 1 services. The hard cap should equal the sum of all the ala carte prices of the individual services in the package.

**Q. What other consumer protections does Staff recommend?**

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[5] Other rate design changes recommended by Mr. Regan result in a combined increase in Qwest's revenue of $1,706, 650 which offsets the $8.9 million access charge reduction for a total impact of 7,193,350.
[6] Revised Price Cap Plan Attachment to Qwest's May 20, 2004 filing, Page 3.

A. Qwest's proposal includes the provision that any Basket 1 service that is included in a package will continue to be offered on a stand alone basis. Staff supports this provision.

**Q. What is Staff's recommendation regarding Qwest's proposal to move all packages to Basket 3?**

A. As long as the two recommendations regarding consumer protections discussed above are implemented, Staff is not opposed to moving all packages to Basket 3.

**Q. How many new services has Qwest introduced over the initial term of the AFOR?**

A. Staff's research indicates that sixteen new services have been introduced by Qwest during the term of the AFOR. Fourteen new services were placed into Basket 1 when introduced:

1. 4/3/2001 Intro Number Forwarding
2. 4/3/2001 Intro Four New Features
3. 4/23/2001 new DSS contracting option
4. 11/19/2001 Intro Qwest Business Line Plus
5. 12/31/2001 Intro ValueChoice
6. 2/19/2002 211, 311 & 511
7. 4/15/2002 Intro Popular Choice and CustomChoice Complete
8. 6/24/2002 Two Line CUSTOMCHOICE Complete
9. 1/13/2003 Intro Digit Manipulation
10. 9/22/2003 Intro Selective Call Waiting
11. 1/5/2004 Intro QWEST CHOICE Home and
12. QWEST CHOICE Home Two-Line
13. 3/2/2004 Business Line Volume Purchase Plan
14. 7/6/2004 Intro new residence packages

Two new services were placed into Basket 3 when introduced:

1. 4/3/2001 Anywhere Voice Mail
2. 9/30/2002 Intro Managed Long Distance

Staff notes that these last two services were placed into Basket 3 because they are substantially similar to services that were already in Basket 3.

**Q. What does Staff recommend regarding the introduction of new services by Qwest?**

A. Staff does not believe that a presumption that *all* new services are competitive is appropriate. Most new services are extensions of or add-ons to basic local service. That is, they are only available to (or useful to) customers who already take basic local service from Qwest. Thus, it would be inappropriate to classify them as competitive on a state-wide basis when there are areas of the state where basic local service is not competitive. Therefore, Staff believes that the current process of evaluating new services through an R14-2-1108 filing should remain in place.

**Q. What other recommendations does Staff have regarding service packages and new services?**

A. Qwest's proposal provides that the price of all service packages and new services should exceed their TSLRIC and comply with the imputation requirements of A.A.C. R14-2-1310(c). Staff supports this provision.

**Q. Has Staff prepared a proposed Revised Price Cap Plan?**

A. Yes. A proposed Revised Price Cap Plan is provided as Exhibit 1 to my testimony.

## III. Competitive Zones

**Q. What is Staff's general recommendation regarding Qwest's Competitive Zone proposal?**

A. In general, Staff supports additional pricing flexibility for Qwest where competition warrants it. While Qwest's proposal contains several aspects that concern us, Staff is not opposed to the general idea of Competitive Zones.

### 1. Qwest's Proposal

**Q. Please describe Qwest's Competitive Zone proposal.**

A. Qwest proposes that certain geographic areas should be deemed by the Commission to be "Competitive Zones." Initially, Qwest is proposing that the geographic areas to be considered should be the wire centers. If a wire center is deemed to be a Competitive Zone, *all* the services Qwest offers in that wire center will be considered to be Basket 3 services and will thus have flexible prices. Additionally, under Qwest's proposal, Qwest will be allowed to price its services differently in each Competitive Zone.

**Q. What is a wire center?**

A. Technically a wire center is the physical structure where an ILEC's local lines are terminated to a switch or switches, also known as a Central Office or end office.[7] When Qwest (and Staff) use the term wire center in the context of the Competitive Zone discussion, what we really mean is the wire center serving area, i.e., the geographic area that is served by a single wire center. I will follow Qwest's convention and refer to the wire center service area simply as a wire center. In densely populated urban areas wire centers can be quite small geographic areas. In rural areas wire centers can be quite large. In the Phoenix metropolitan statistical area (MSA) there are approximately 64 different wire centers. In the Tucson MSA there are approximately 22 wire centers. Whereas there are only approximately 47 wire centers in Qwest's service territory outside of the Phoenix and Tucson MSAs. In total there are approximately 133 Qwest wire centers.

**Q. Are wire centers the only geographic area that Qwest is proposing be considered for Competitive Zone treatment?**

A. Qwest has provided a list of wire centers that it believes should be classified as Competitive Zones in this proceeding (63 in the Phoenix MSA and 19 in the Tucson MSA.) However, Mr. Teitzel testifies that since CLECs often target smaller geographic areas such as business parks and housing developments, Qwest should have the flexibility to seek Competitive Zone treatment for these smaller areas in the future.[8]

**Q. What pricing flexibility is Qwest seeking within Competitive Zones?**

A. Qwest proposes that within Competitive Zones all services shall have a maximum rate and that as long as the actual price of a service does not exceed the maximum rate, price changes will go into effect immediately upon notice to the Commission by filing of a

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[7] See Newton, Harry *Newton's Telecom Dictionary 20th Edition* CMP Books 2004
[8] Tietzel p.72 line 18 – p. 73 line 1

revised price list.[9] Qwest also wants the ability to set different actual rates for the same service in different Competitive Zones, i.e., in different wire centers.

**Q. What criteria does Qwest propose be used to establish a Competitive Zone?**

A. Qwest's proposed criteria are quite simple. Qwest proposes that a wire center be deemed a Competitive Zone if *any one* of the following criteria is met:

1. A competitor has facilities in place and is marketing or offering services in competition with Qwest; or,
2. A competitor is marketing or offering services through the provision of unbundled network elements provided by Qwest; or,
3. A competitor is marketing or offering services through the resale of Qwest's service.[10]

**Q. How does Qwest propose the maximum rates for services in Competitive Zones be set?**

A. It is not clear how the maximum rates for services provided within Competitive Zones will be set under Qwest's proposal. Nowhere in Qwest's testimonies is it explained how the level of the maximum rates would be determined; it is only stated that Qwest will file tariffs with maximum rates.[11] In response to Staff data request 15-2 which asked how Qwest proposed the maximum rates be established, Qwest stated that the maximum rates in Competitive Zones could be higher than current rates but offered no insight into how the level of maximum rates would be determined.

**Q. Would Qwest's Competitive Zone proposal give Qwest the same pricing flexibility that CLECs in Arizona currently have?**

A. No. Upon close examination it is apparent that Qwest's proposal would give Qwest *more* pricing flexibility than the CLECs now have. Both Mr. Shooshan and Mr. Teitzel testified that Qwest's Competitive Zone proposal would simply give Qwest the same pricing flexibility currently enjoyed by its CLEC competitors.[12] However, this is simply not the

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[9] Tietzel P. 73 lines 5-7.
[10] See the attachment to Qwest's May 20, 2004 filing: "Revised Price Cap Plan Terms, Conditions and Operation of the Revised Price Cap Plan."
[11] i.d.
[12] Tietzel p. 73 line 16 – page 74 line16 and Shooshan p. 15 lines 4-15

case. At page 74 lines 3-14 of his testimony Mr. Teitzel provides examples of CLECs who he claims have the same pricing flexibility that Qwest is seeking:

> "...several CLECs have identified specific wire centers in which they will provide service. For example, Sprint's tariff indicates its business Local Exchange Service is available in Qwest wire centers identified as UNE Zones 1 and 2. Section 5 of McLeodUSAs Arizona Tariff No. 3 lists the cities and wire centers where McLeod is offering service, either over its own switch or through the use of network elements. Cox initially rolled out cable telephony service to consumers in the Chandler area, eventually extended its facilities to the greater Phoenix area a few years later, and just recently began offering service in Tucson."

These examples demonstrate that these CLECs have flexibility in *where* they provide service. This is different from the *pricing* flexibility that Qwest is seeking. Staff is not aware of any CLEC that has tariffs on file that allow it to price its services differently in each wire center. For the most part, CLECs have statewide tariffs and must charge uniform rates wherever they are serving. There are some CLECs that have different prices in the different UNE rate zones (e.g., McLeodUSA) however that is quite different from the flexibility Qwest is seeking in this proceeding. If Qwest is granted zone based pricing flexibility, the CLECs could very well apply for the same type of flexibility.

**Q. How would the pricing flexibility Qwest is proposing compare to that currently enjoyed by Qwest's principal competitor, Cox Communications[13]?**

A. Qwest's proposal would give it much more pricing flexibility than Cox currently has. Currently Cox's tariffed rates apply to all of its customers in Arizona. Cox is not currently able to charge customers in different wire centers (or other geographic areas) different rates. Also, Cox's rates for basic residential and business service are capped at their current levels: $13 for residential and $30 for business. This contrasts with Qwest's

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[13] Staff considers Cox to be Qwest's principal competitor because Cox is the only CLEC that uses its own facilities exclusively, it has far more residential customers than any other CLEC, and it has a substantial number of business customers.

proposal, which would allow Qwest to submit maximum rates for basic service that are above current levels.

**Q. Has Qwest made a Competitive Zone proposal before?**

A. Yes, in Qwest's last price cap proceeding Qwest made a proposal regarding Competitive Zones similar to the one it is making now. The Commission rejected the Competitive Zone proposal at that time but did state that the idea of Competitive Zones could be acceptable under certain circumstances. Specifically, Decision No. 63487 (at page 19 lines 16-27) states that: "In the future, the parties may be able to fashion a provision that allows Qwest to compete in areas where it truly faces established competition, but such provision must better describe the geographic areas and population served as well as promote specific and clear protections against anti-competitive behavior."

**Q. Does Qwest's current Competitive Zone proposal conform to the requirements of Decision No. 63487 quoted above?**

A. No. Staff is unable to discern any "specific and clear protections against anti-competitive behavior" in Qwest's current proposal. In response to Staff data request 15-1, which inquired about Qwest's opinion regarding the requirements of Decision No. 63487, Qwest states, "the provisions of R14-2-1108(H) give the ACC full authority to rescind Competitive Zone classification should such 'anticompetitive behavior' be shown to exist." Since rule R14-2-1108(H) existed at the time Decision No. 63487 was issued, it is unlikely that the Commission, at that time, believed the Rule was sufficient to address its concerns. In my testimony below, I propose several modifications to Qwest's proposal that should address concerns about anti-competitive behavior. Most importantly Staff believes that the criteria Qwest proposes for Competitive Zone classification are inadequate. Staff believes that these modifications along with the Commission's imputation rules (A.A.C. R14-2-1310(C)) should provide significant protections against anti-competitive behavior.

**Q. Please state Staff's general opinion of Qwest's Competitive Zone proposal.**

A. Staff is not opposed to the idea of Competitive Zones in general. Allowing Qwest to have the ability to respond to its competitors does seem on its face to be fair. However, the proposal that Qwest put forward contains very little detail. It is not clear to Staff how their proposal would be administered. Before any Competitive Zone proposal is adopted Qwest should be required to provide a detailed plan of administration to the Commission. Additionally, certain specific elements of the proposal made by Qwest are of concern to Staff. Staff cannot recommend adoption of Qwest's Competitive Zone proposal unless the following elements of that proposal are addressed:

- Provider of last resort obligation
- Consumer protections
- Geographic areas
- Consumer notice problem
- Potential for bait and switch
- Criteria for determining if a zone is competitive
- Specific wire centers identified by Qwest as competitive

**2. Provider of last resort obligation**

**Q. What are Staff's concerns regarding how Qwest's Competitive Zone proposal would affect Qwest's provider of last resort obligations?**

A. Qwest's testimonies do not address the provider of last resort obligation at all. However, in response to Staff data requests 17-1 and 28-1 Qwest indicated that under its proposal once a zone is declared competitive by the Commission, Qwest would no longer have any provider of last resort obligations in that area. Qwest also indicated that the Commission should open a generic docket to address the issue of provider of last resort obligations in Competitive Zones. Qwest indicated it was not willing to maintain its provider of last resort obligation while that generic docket is pending. This causes concern for Staff because if Qwest's proposal is approved most of the state (on a population basis) would be without a provider of last resort.

**Q. Why is the provider of last resort obligation important?**

A. The provider of last resort obligation provides a guarantee that wire line telecommunications service will be available to any customer.

**Q. What is Staff's recommendation regarding Qwest's provider of last resort obligation?**

A. Qwest has provided no evidence that relinquishing their provider of last resort obligation is in the public interest. (In fact they did not even mention that it was a part of their Competitive Zone proposal until they were asked about it in Staff's discovery.) Currently there is no workable method of sharing the provider of last resort obligation among Qwest and the CLECs. Staff recommends that Qwest maintain its provider of last resort obligations over its entire service area regardless of whether particular areas are deemed to be Competitive Zones. Should the Commission follow Qwest's suggestion and open a generic docket to investigate this issue, Staff recommends that Qwest maintain its provider of last resort obligations at least until that generic docket is concluded.

**3. Consumer Protections**

**Q. What consumer protections are included in Qwest's Competitive Zone proposal?**

A. On its face, Qwest's Competitive Zone proposal contains no consumer protections yet it exposes consumers to significant risk.

**Q. What are the risks that Qwest's proposal would impose on consumers?**

A. Under Qwest's proposal consumers may be subject to significant price increases for basic services. In response to Staff data request 15-2 Qwest stated that under their proposal maximum rates for basic service could be set at levels in excess of their current prices. This would allow Qwest to raise the price for basic services in particular zones as it deems appropriate. Staff does not believe that such "at will" price increases for basic services are appropriate.

**Q. Would not competition constrain Qwest's ability to raise the prices of basic services?**

A. If the market for telecommunications services were truly vibrantly competitive, then Qwest's ability to raise prices would be constrained. However the factual evidence (explained in Staff witness Armando Fimbres' testimony) is not conclusive. Exhibit AFF-7 indicates that there is only one CLEC that is a serious competitor for residential consumers (Cox.) Also, the only two other CLECs that have any significant presence in the residential market (AT&T and MCI) recently announced that they are withdrawing from the residential local exchange market. On the business side there are several CLECs competing but their combined market share is still dwarfed by Qwest's. Mr. Fimbres has also calculated several different Herfindahl-Hirschman Indexes ("HHI") in order to gauge the degree of concentration in the Arizona telecommunications market. The HHI measures both the number of firms and their relative degree of inequality. The HHI is the sum of the squares of each firm's market share. This is given by the formula:

$$HHI = \sum_{i=1}^{N} S_i^2$$

Where $S_i$ is the market share of the ith firm and N is the total number of firms.[14] All else equal, the more concentrated a market is the more likely it is that sellers will be able to raise prices above competitive levels. The United Stated Department of Justice, when evaluating horizontal mergers, views market concentration as a problem when the HHI is 1800 or higher. Mr. Fimbres calculated HHIs for the Arizona wire line

[14] For example, a market consisting of four firms with market shares of 30 percent, 30 percent, 20 percent and 20 percent has an HHI of 2600 ($30^2 + 30^2 + 20^2 + 20^2 = 2600$). The HHI ranges from 10,000 (in the case of a pure monopoly) to a number approaching zero (in the case of a perfectly competitive market). Although it is desirable to include all firms in the calculation, lack of information about small firms is not critical because such firms do not affect the HHI significantly.

telecommunications market several different ways based on the different sources of data he used. All of the HHIs Mr. Fimbres calculated were well above the 1800 standard, even those that include wireless providers.

Staff does not interpret this factual evidence to mean that competition is insignificant or that there is no hope for competition in the future. However, Staff does not believe that the evidence supports the conclusion that the market is vibrantly competitive and that no consumer protections are needed.

Q. **What recommendations does Staff have regarding consumer protections and Competitive Zones?**

A. Staff recommends that the maximum rates for basic services in Competitive Zones should be set at their current levels. This will protect consumers against potentially unwarranted price increases. It will also allow Qwest the flexibility to compete. Qwest will be able to lower prices in areas where competition is particularly acute without having to lower prices across its whole territory. Qwest is claiming that it needs Competitive Zones in order to compete more effectively.[15] Companies generally do not compete by raising prices. Also, if the market is currently competitive enough to constrain the prices of basic services, this requirement will have no effect on Qwest because they would not be able to raise prices without losing a significant number of customers anyway.

Q. **What are the basic services that Staff believes should be capped at their current levels?**

A. Staff believes prices of the following services should be capped at their current levels: flat rate residential; flat rate business; exchange zone increment charges; low use option service; service stations service; telephone assistance programs; individual PBX Trunks,

[15] Ziegler p. 10 lines 7-10, Teitzel p. 72 line 20

including features; Caller ID block; toll blocking; 900/976 blocking; and basic listing service.

**4. Geographic area**

**Q. What geographic area is Qwest proposing be used to define Competitive Zones?**

A. Qwest is proposing that the wire center be the initial geographic area but believes smaller areas, such as particular developments, should be allowed for consideration in the future.

**Q. What are Staff's concerns regarding use of wire centers to define Competitive Zones?**

A. The wire center will have advantages and disadvantages if it is used for that purpose. The advantage of using the wire center is that information on UNE-L, UNE-P, and resold lines is readily available to Qwest at the wire center level. Thus, a detailed analysis of that type of information is possible for each wire center. The disadvantages of the wire center are that listing information is not available at the wire center level, information on CLECs who use their own network exclusively is not available at the wire center level (but Qwest has provided problematic estimates), information on wireless carriers and VOIP providers is not available at the wire center level and customers are not familiar with the concept of a wire center.

Staff believes that the decision of whether an area should be deemed competitive should be based on an analysis of the available facts. Certain facts are available at the wire center level. The number of competitors serving customers in a wire center through UNE-L, UNE-P, and resale is known to Qwest. Also the specific number of lines each such competitor is serving in a wire center is known to Qwest. However, Qwest may not know how many different customers each competitor is serving. This may be important to the Commission; one competitor serving one customer with 1,000 lines (e.g., a call center) is different from a competitor serving 1,000 customers each with one line. Listings

information can tell us how many customers each CLEC has but not how many lines. Listings information is broken down geographically by area-code boundaries which are much larger than wire centers. Another problem with analyzing competition at the wire center level is that pure facilities based competitors (such as Cox) do not use wire center boundaries and thus they are unable to tell us how many customers or lines they are serving in each (Qwest) wire center. Also, Qwest does not know how many customers facilities based CLECs are serving in each wire center. They have provided us with estimates based on Local Interconnection Service ("LIS") trunks but those estimates are problematic because several CLECs appear to have LIS trunks but are not using them to provide voice telecom service (or not using them at all.) These data problems are explained more fully in the testimony of Staff Witness Armando Fimbres.
Another problem with using the wire center is that it would not be competitively neutral. Staff believes that any Competitive Zone proposal should be competitively neutral. Since wire center boundaries are based on the locations of *Qwest's* central offices Qwest knows which addresses are in which wire centers. CLECs can map addresses into wire centers by using Qwest's data bases but that mapping process could be an administrative burden for them.

Aside from these problems, wire centers present a problem when it comes to communicating with consumers. People not familiar with the telecom industry do not know what a wire center is. Very few people know what wire center they live in.[16] Thus, if prices vary across wire centers it will be difficult to communicate to customers why it is that the prices available to them differ from those available to their neighbors.

[16] ILECs intentionally moved away from a related scheme used long ago when numbers began with the letters of the end-office, e.g., EM4-1212 or LA3-1212. Reacquainting customers with this concept seems anachronistic.

**Q. What other options are there for the geographic areas that define Competitive Zones?**

A. There are several options, each of which has its advantages and disadvantages. Other geographic areas that Staff considered are:

- Zip codes
- Area code boundaries
- Rate Centers
- Metropolitan Statistical Areas ("MSAs")
- Counties
- LATAs

Zip codes have the advantage of being readily understood by consumers; most people know what zip code they are in. However, it has been difficult to find information on competition specific to individual zip codes. Many carriers have been thus far unable to tell us how many customers or lines they are serving in each zip code. (This may seem counter intuitive since CLECs do send their bills through the mail but for many business customers the billing address is different from the service address.)

Area code boundaries have the advantage when it comes to data. Wire centers can be easily mapped into area code boundaries and listings information is available at the area code boundary level. However, using area code boundaries could result in wire centers that are not competitive being deemed competitive. Also, area code boundaries would not give Qwest the competitive flexibility it is seeking.

Rate Centers are similar to area code boundaries. The data availability issues are less dramatic since CLEC rate centers tend to be the same as Qwest rate centers but they are large enough that non-competitive wire centers may be lumped in with competitive wire centers and the pricing flexibility they afford Qwest is limited.

MSAs, counties, and LATAs are also so large that non-competitive wire centers may be lumped in with competitive wire centers and the pricing flexibility they afford Qwest is limited.

**Q. What geographic area does Staff recommend be used as the basis for Competitive Zones?**

A. As the above discussion lays out any geographic area that is considered will have pros and cons. While the data available at the zip code level has been limited, Staff believes this limitation can be overcome. Designating Competitive Zones at the zip code level will provide Qwest with a great deal of competitive flexibility and will allow for a comparison of all types of competition. Additionally, consumers are familiar with the concept of zip codes and this will help alleviate the customer notice problems discussed below.[17] For these reasons Staff believes that, should the Commission decide to adopt a Competitive Zone proposal for Qwest, the zip code should be the geographic area used as the basis of the Competitive Zones.

For larger zip codes, the Competitive Zone designation could be narrowed to only a portion of the zip code as competitive conditions warrant.

**Q. Please provide general information about zip codes.**

A. There are 74 different zip codes within the city limits of Phoenix, 186 zip codes within Maricopa County, and 215 zip codes within the Phoenix MSA. There are 51 zip codes within the city limits of Tucson and 65 zip codes within Pima County and the Tucson MSA. There is a zip code map attached to my testimony as Exhibit 2.

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[17] Zip code compilations are also used by the FCC when examining broadband deployment levels.

**Q. Qwest has stated that while they are asking for Competitive Zone treatment at the wire center level now, they should be free to apply for Competitive Zone treatment for smaller geographic areas like housing developments or office parks. What are Staff's recommendations regarding these smaller geographic areas?**

A. Staff did try to analyze the competitive situations in particular developments identified by Qwest; however, Staff was unable to find any data at that level of granularity. Conceptually, Staff has no objection to using these smaller areas. However, should Qwest apply to the Commission for Competitive Zone treatment in these smaller areas it should be required to provide a factual basis for that determination. In order to gain approval for a smaller zone, Qwest must provide the Commission with the same level of detailed information as is available for zip codes.

**Q. Would using zip codes as the basis for Competitive Zones be administratively burdensome to Qwest?**

A. It would certainly be easier for Qwest to use the wire center as the basis for Competitive Zones. However, using zip codes should not be an unmanageable task for them. They should have zip code information on all of their customers and even if they don't, mapping street addresses into zip codes is certainly possible. More importantly, Staff believes that any Competitive Zone proposal should be *competitively neutral*, i.e., it should not favor the CLECs or Qwest. Qwest's proposal to use wire centers as the basis for Competitive Zones actually gives it an advantage over most CLECs. Most CLECs do not know the exact boundaries of Qwest's wire centers, especially those that use only their own facilities. Thus, under Qwest's proposal, it may be administratively burdensome for the CLECs to determine which of their customers are in Competitive Zones. It seems fair that the CLECs should know where the Competitive Zones are so that they can tailor their offerings accordingly. Using zip codes will put the same administrative burden on Qwest and the CLECs regarding keeping track of which customers are in Competitive Zones.

Using wire centers will put an administrative burden on the CLECs but not on Qwest. In summary, Staff believes that any Competitive Zone proposal should be competitively neutral and because the wire center is a vestige of the incumbent's legacy network, it can not be considered to be competitively neutral.

**5. Consumer notice problem**

**Q. Please explain what Staff means by the consumer notice problem.**

A. Qwest is obligated to maintain tariffs that list the prices for all of its tariffed services. Qwest has also agreed to publish a short list of basic services and their prices in the Qwest Dex directory. When Qwest Dex was sold, the publishing agreement between Qwest and the acquirers included provisions that all existing and new regulatory obligations would be adhered to. Thus, a short list of Qwest's basic rates has been included in the Qwest Dex Directory. If Qwest's Competitive Zone proposal is adopted by the Commission it may be difficult to continue the publication of basic rates in Qwest Dex and it may be difficult to maintain meaningful tariffs. Qwest is seeking Competitive Zone treatment in 82 different wire centers. That could mean 83 different rates for each service that would have to be listed in the tariff and in Qwest Dex (the 82 Competitive Zones plus the non-competitive area.) Qwest's responses to Staff data requests 12-8, 12-9, and 12-10 make it clear that Qwest intends to be able to price its services differently in each wire center. A tariff with 83 different rates for the same service could be unintelligible. Also, including 83 different rates for each basic service in Qwest Dex would be quite confusing for customers, especially given that most customers are unfamiliar with the concept of a wire center. This would defeat the whole purpose of including information on basic services in Dex.

**Q. Is it really likely that there will be 83 different rates for a given service under Qwest's proposal?**

A. While Qwest would have the ability to charge 83 different rates for a particular service, it is probably not likely to do so. It doesn't seem likely that such extreme price differentiation would be desirable to Qwest or manageable by Qwest. However, there is the potential for several different rates for a given service at any one time and thus there is still a customer notice concern.

**Q. Are there other similar problems that would need to be addressed in order to adopt Qwest's proposal?**

A. Yes. Qwest's proposal, which could include 83 different rates for services, would put a considerable administrative burden on the Commission. The Commission is required to maintain tariffs available for public inspection. The multitude of tariff filings that could result from Qwest's proposal would make this difficult.

**Q. What does Staff recommend regarding this customer notice problem?**

A. With respect to the basic services listed in the Dex directory, Staff recommends that Qwest continue to be required to have its rates for basic service published in the directory. In order to avoid customer confusion, only the maximum rates should be included in the directory. Further, as stated above, maximum rates for basic services should be capped at their current levels.

**6. Potential for bait and switch**

**Q. What does Staff mean by the potential for bait and switch?**

A. Under Qwest's Competitive Zone proposal Qwest could offer customers in certain areas discounted prices and then raise those prices back up to the maximums with minimal notice. Staff believes that there is the potential for customer harm as a result.

**Q. What does Staff recommend regarding this potential problem?**

A. Staff recommends that any discounts provided to a Competitive Zone remain in place for at least one year unless Qwest clearly notifies its customers that the discount is temporary and clearly explains what the duration of the discount will be. If Qwest wants to offer a discount for a limited period of time it should be free to do so; however, both new and existing customers should be clearly notified of the limited duration of the discount. Absent such notification, any discounts provided to Competitive Zones should remain in effect for a minimum duration of one year.

**Q. CLECs do not have such a requirement. Why should Qwest have this restriction and not the CLECs?**

A. The evidence presented in my and Mr. Fimbres' testimonies indicates that the telecom market in Arizona is highly concentrated and that Qwest still retains the dominant position. Given Qwest's dominant position in the market it is reasonable to place restrictions on it that other carriers do not have.

**7. Criteria for determining if a zone is competitive**

**Q. What criteria does Qwest propose be used to determine if an area should be deemed a Competitive Zone?**

A. Qwest proposes that a wire center be deemed a Competitive Zone if *any one* of the following criteria is met:

1. A competitor has facilities in place and is marketing or offering services in competition with Qwest; or,
2. A competitor is marketing or offering services through the provision of unbundled network elements provided by Qwest; or,
3. A competitor is marketing or offering services through the resale of Qwest's service.[18]

**Q. What are Staff's concerns with these criteria?**

A. Staff believes these criteria are far too loose. These criteria would allow for the establishment of a Competitive Zone in an area where there is only one reseller operating. Staff does not believe that the existence of one reseller constitutes real competition.

[18] See the attachment to Qwest's May 20, 2004 filing: "Revised Price Cap Plan Terms, Conditions and Operation of the Revised Price Cap Plan."

Two concerns exist with Qwest's proposed criteria. One is the use of the lowest possible metric, such as "A competitor…" which Staff interprets to mean one competitor. The simple presence of one competitor gives no weight to important elements such as volume of competition, breadth of competition, or sustainability of competition. A second concern with the criteria offered by Qwest is the equal weight or relevance given to three factors which are in different stages of use and acceptance by CLECs. By the simple metrics offer by Qwest, all proposed wire centers could conceivably be classified as Competitive Zones with very little analysis, however, the broad availability of sustainable competitive alternatives in any geographic area remains a concern for Staff.

**Q. Are there any current established criteria used for competitive determinations in Arizona?**

A. Yes. The Arizona Administrative Code already has criteria laid out for determining that a telecommunications *service* is competitive. Specifically, rule R14-2-1108(B) provides that:

> The petition for competitive classification shall set forth the conditions within the relevant market that demonstrate that the telecommunications service is competitive, providing, at a minimum, the following information:
> 1. A description of the general economic conditions that exist which make the relevant market for the service one that is competitive;
> 2. The number of alternative providers of the service;
> 3. The estimated market share held by each alternative provider of the service;
> 4. The names and addresses of any alternative providers of the service that are also affiliates of the telecommunications company, as defined in R14-2-801;
> 5. The ability of alternative providers to make functionally equivalent or substitute services readily available at competitive rates, terms, and conditions; and
> 6. Other indicators of market power, which may include growth and shifts in market share, ease of entry and exit, and any affiliation between and among alternative providers of the services.

**Q. The criteria established in rule 1108(B) were designed for the classification of a particular service as competitive not the establishment of Competitive Zones. Are the 1108(B) criteria appropriate for the purpose of establishing Competitive Zones?**

A. Yes. The classification of a given company's services as competitive and the classification of geographic areas as competitive are conceptually similar. The information required by 1108(B) is as relevant to the classification of geographic areas as competitive as it is to the classification of particular services as competitive.

**Q. Has Qwest explained why the criteria for establishing a Competitive Zone should differ from the criteria already established in 1108(B)?**

A. No. Qwest has not explained why a deviation from the standard established in R14-2-1108(B) is appropriate or necessary. Interestingly, Qwest believes the 1108 rule is appropriate in the instance when competitive conditions change (e.g., all the competitors leave a Competitive Zone) and competitive classification of a zone needs to be reversed. In that instance Qwest believes that R14-2-1108(H) should apply.[19] R14-2-1108(H) states:

> Any telecommunications service classified by the Commission as competitive may subsequently be reclassified as noncompetitive if the Commission determines that reclassification would protect the public interest. Notice and hearing would be required prior to any reclassification. The burden of proof would be on the party seeking reclassification.

So Qwest believes that the 1108 rule is appropriate to declassify areas as Competitive Zones but Qwest does not believe R14-2-1108 is appropriate for classifying areas as competitive. Staff can not explain this apparent double standard in Qwest's recommended application of R14-2-1108 to its Competitive Zone proposal.

**Q. Does Staff believe that a deviation from the standard established in rule 1108(B) is appropriate or necessary?**

A. No. Rule 1108(B) allows the Commission to examine the relevant factual information needed to evaluate the competitive situation in a given area. R14-2-1108(B) also allows the Commission great flexibility in how it chooses to use that factual information.

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[19] Teitzel p. 76 lines 1-4.

Qwest's proposed criteria would only allow the Commission to perform the most cursory factual review. Given Qwest's dominant position relative to the CLECs, Staff can not recommend that the criteria for establishing Qwest's services as competitive be less stringent than the criteria for establishing CLEC services as competitive. To the contrary, because Qwest is the entrenched dominant provider for local service throughout its service territory the criteria used to determine whether competitive classification is appropriate should be more stringent for Qwest. In other words, given Qwest's market dominance in most areas, Staff recommends that additional factors be considered for Qwest than those used in the past by Staff and the Commission.

**7. Specific wire centers identified by Qwest as competitive**

**Q. Where is Qwest requesting Competitive Zones?**

A. Qwest is requesting Competitive Zone classification for 63 wire centers in Phoenix metro and 19 wire centers in Tucson metro. This represents 60% of Qwest's 136 wire centers in Arizona. Of Qwest's total Arizona wire centers, 39 are UNE Zone 1, 33 are Zone 2 and 64 are Zone 3. Qwest is requesting competitive flexibility in the form of Competitive Zones in 37 of 39 UNE Zone 1 wire centers, 17 of 33 Zone 2 wire centers and 28 of 64 Zone 3 wire centers. Furthermore, the Competitive Zone requests consist of 29 UNE Zone 1, 11 Zone 2 and 23 Zone 3 wire centers in Phoenix metro. Similarly, 8 UNE Zone 1, 6 Zone 2 and 5 Zone 3 Competitive Zone wire centers are being requested for Tucson metro. (see Exhibit AFF-4) Qwest is requesting Competitive Zone classification for every wire center that can reasonably be considered in the Phoenix metro and Tucson metro, with the exception of Marana West. It is also worth noting that the wire centers for which Qwest is requesting Competitive Zone classification constitute about [redacted] lines or [redacted] of their total switched access lines in Arizona.

**Q. What concerns does Staff have with the wire centers Qwest has identified as competitive?**

A. Staff is concerned that some of the wire centers Qwest has identified as competitive actually have very little competitive activity. The inclusion of these wire centers is likely a result of the criteria that Qwest employed to identify competitive wire centers.

**Q. How did Staff determine that some of the wire centers Qwest has identified as competitive actually have very little competitive activity?**

A. Taking wire center data provided by Qwest, Staff developed an estimate of CLEC market share in each wire center. In response to RUCOs data request 2.28A through 2.28F, Qwest provided UNE-L, UNE-P, and resale numbers per wire center. In response to RUCO data request 2.38 Qwest provided its *estimate* of pure facilities based CLEC lines. Combining this information with data on Qwest's lines contained in Qwest Exhibit DLT-17 yields the following CLEC market shares per wire center in the Phoenix and Tucson areas:

**Table 5 CLEC Market Share for Phoenix Wire Centers identified by Qwest as Competitive Zones**[20]

| Wire Center Name | Estimated CLEC Market Share |
|---|---|
| **DUDLEYVILLE** | **[redacted]** |
| **WHITLOW** | **[redacted]** |
| **RIO VERDE** | **[redacted]** |
| **KEARNY** | **[redacted]** |
| **ORACLE** | **[redacted]** |
| **FLORENCE** | **[redacted]** |
| **WHITE TANKS** | **[redacted]** |
| **MAMMOTH** | **[redacted]** |

[20] The Phoenix MSA includes all of Maricopa and Pinal counties. Dudleyville, Kearney, Oracle, Mammoth, and San Manuel are not in the Phoenix LATA and not in the Phoenix local calling area but are in the Phoenix MSA. Florence, Superior, Coolidge, Eloy, Gila Bend, and Casa Grande are in the Phoenix LATA and MSA but not in the Phoenix local calling area.

| | |
|---|---|
| **SUPERIOR** | **[redacted]** |
| **CIRCLE CITY** | **[redacted]** |
| **STANFIELD** | **[redacted]** |
| **COOLIDGE** | **[redacted]** |
| **WICKENBURG** | **[redacted]** |
| **WINTERSBURG** | **[redacted]** |
| **MARICOPA** | **[redacted]** |
| **ELOY** | **[redacted]** |
| **GILA BEND** | **[redacted]** |
| **BUCKEYE** | **[redacted]** |
| **HGLY QUEEN CREEK** | **[redacted]** |
| **NEW RIVER** | **[redacted]** |
| **TOLLESON** | **[redacted]** |
| **PINNACLE PEAK** | **[redacted]** |
| **PHOENIX-LAVEEN** | **[redacted]** |
| **DEER VALLEY NORTH** | **[redacted]** |
| **PHOENIX-SUNNYSLOPE** | **[redacted]** |
| **THUNDERBIRD** | **[redacted]** |
| **CHANDLER-SOUTH** | **[redacted]** |
| **PHOENIX-NORTHEAST** | **[redacted]** |
| **SUPERSTITION-EAST** | **[redacted]** |
| **PHOENIX-EAST** | **[redacted]** |
| **SCOTTSDALE** | **[redacted]** |
| **CAVE CREEK** | **[redacted]** |
| **HIGLEY** | **[redacted]** |
| **CHANDLER-WEST** | **[redacted]** |
| **FORT MCDOWELL** | **[redacted]** |
| **PHOENIX-MID RIVERS** | **[redacted]** |
| **PHOENIX-SOUTHEAST** | **[redacted]** |
| **SUPERSTITION-MAIN** | **[redacted]** |
| **BEARDSLEY** | **[redacted]** |

| | |
|---|---|
| **SUPERSTITION-WEST** | **[redacted]** |
| **TEMPE-MAIN** | **[redacted]** |
| **MESA-MAIN** | **[redacted]** |
| **PHOENIX-GREENWAY** | **[redacted]** |
| **CHANDLER-MAIN** | **[redacted]** |
| **LITCHFIELD PARK** | **[redacted]** |
| **PHOENIX-WEST** | **[redacted]** |
| **SHEA** | **[redacted]** |
| **PHOENIX-SOUTH** | **[redacted]** |
| **GLENDALE-MAIN** | **[redacted]** |
| **PHOENIX-NORTH** | **[redacted]** |
| **GILBERT** | **[redacted]** |
| **PHOENIX-CACTUS** | **[redacted]** |
| **PHOENIX-FOOTHILLS** | **[redacted]** |
| **PHOENIX-NORTHWEST** | **[redacted]** |
| **TEMPE-MCCLINTOCK** | **[redacted]** |
| **PHOENIX-PEORIA** | **[redacted]** |
| **PHOENIX-MARYVALE** | **[redacted]** |
| **PHOENIX-PECOS** | **[redacted]** |
| **CASA GRANDE** | **[redacted]** |
| **COLDWATER** | **[redacted]** |
| **PHOENIX-BETHANY WEST** | **[redacted]** |
| **SAN MANUEL** | **[redacted]** |
| **PHOENIX-MAIN** | **[redacted]** |

**Table 6 CLEC Market Share for Tucson Wire Centers identified by Qwest as Competitive Zones**

| Wire Center Name | Estimated CLEC Market Share |
|---|---|
| **MARANA** | **[redacted]** |
| **MOUNT LEMMON** | **[redacted]** |
| **VAIL NORTH** | **[redacted]** |
| **TUCSON WEST** | **[redacted]** |
| **TUCSON SOUTHWEST** | **[redacted]** |
| **TUCSON-SOUTH** | **[redacted]** |
| **GREEN VALLEY** | **[redacted]** |
| **TUCSON-EAST** | **[redacted]** |
| **CRAYCROFT** | **[redacted]** |
| **VAIL SOUTH** | **[redacted]** |
| **RINCON** | **[redacted]** |
| **CATALINA** | **[redacted]** |
| **TUCSON-NORTH** | **[redacted]** |
| **CORONADO** | **[redacted]** |
| **CORTARO** | **[redacted]** |
| **TANQUE VERDE** | **[redacted]** |
| **TUCSON SE** | **[redacted]** |
| **FLOWING-WELLS** | **[redacted]** |
| **TUCSON-MAIN** | **[redacted]** |

Tables 5 and 6 list only the wire centers that Qwest has recommended be designated Competitive Zones, the tables do not include all wire centers. It needs to be stressed that the estimated CLEC market shares in Tables 5 and 6 are based in part on Qwest's *estimates* of pure facilities based CLEC lines. As is discussed above and in the testimony of Staff witness Fimbres, Qwest's estimates of pure facilities based lines probably under estimates Cox's presence but overestimates the presence of other carriers.

**Q. How do Tables 5 and 6 Illustrate Staff's concerns with the wire centers Qwest believes should be designated as Competitive Zones?**

A. Staff believes that there should be actual confirmed competition in an area before it is designated as competitive. Staff is not persuaded that wire centers that have very little actual competition should be designated as competitive. Some of the wire centers listed in Tables 5 and 6 have very little confirmed CLEC activity. Many of the wire centers have CLEC penetration rates in the single digits (or less.) Additionally, the higher CLEC penetration rates shown for some wire centers are driven mainly by Qwest's *estimate* of pure facilities based competition. In fact, fully 69% of the CLEC presence in the Phoenix wire centers listed in Table 5 is attributable to Qwest's *estimate* of facilities based competitors presence. Similarly, 64% of the CLEC presence in the Tucson wire centers listed in Table 6 is attributable to Qwest's *estimate* of facilities based competitors presence. Given that so much of the available evidence regarding these Competitive Zones is driven by Qwest's estimates (which are problematic) Staff is uncomfortable with designating these specific wire centers as competitive.

**8. Staff's recommendation regarding Competitive Zones**

**Q. Please summarize Staff's recommendations concerning Competitive Zones.**

A. Conceptually Staff is not opposed to the idea of establishing Competitive Zones. As long as the consumer protections discussed above are in place, Staff does not believe that the general idea of Competitive Zones will be harmful to consumers. However, Staff finds it difficult to support the specific proposal laid out in Qwest's testimonies. Staff is concerned about the use of the wire center as the geographic basis for the Competitive Zones. Should the Commission decide to approve the concept of Competitive Zones, Staff recommends that zip code boundaries be used as the geographic basis for the Competitive Zones. However, if the data submitted by Qwest and other carriers support Competitive Zone classification for only a portion of the zip code area; the Commission should have the option of narrowing the area to which the Competitive Zone designation would apply.

**Q. Why does Staff believe that zip codes are preferable to wire centers?**

A. Staff's main concern with the wire center is the potential for customer confusion. As discussed above, customers are unfamiliar with the concept of wire centers and thus communicating with them regarding their rates could be problematic. Customers are familiar with the zip code concept which could serve to mitigate some customer confusion.

Another concern is the measurement data needed for a competitive determination. At the wire center level, the only practical data available for evaluating the level of competition is contained within Qwest's interconnection databases. Wire centers are historical, wire line, local exchange designations used only by ILECs, such as Qwest. Many new telecommunications entrants do not define their service areas on the same terms. Analyzing competitive information on the basis of Qwest's wire centers is impractical for inclusion of the broad set of market participants.

Zip codes are geographic definitions provided by the US Postal Service and used by *all* telecommunications providers for service and billing operations. Using zip code based information would allow Competitive Zone consideration at the highest level – statewide - or the lowest level – the discrete zip code – with several possibilities in between, such as city and county levels. Without use of zip code information, for example, analytical consideration of Qwest's related proposal for Competitive Zones defined by geographies other than wire centers, e.g., housing developments, is impractical. The use of zip code level information also lays the groundwork for the eventual inclusion of market information from competitive alternatives, such as wireless and VoIP.

Staff initiated actions to obtain zip code level information for this proceeding but has been unable to conclude its analysis based on such information. Therefore, Staff conducted its Competitive Zone analysis with traditional wire center information but is recommending that the Commission order continuing measurement and analysis be based on zip code information.

**Q. How does Staff propose this analysis based on zip code information be conducted?**

A. If the Commission endorses the idea of establishing Competitive Zones and adopts Staff's recommendation to base those zones on zip codes, Staff recommends that a separate proceeding be established to determine which zip codes should be treated as Competitive Zones. After the conclusion of the pending proceeding, Qwest could make a filing consistent with R14-2-1108 which would identify the zip codes Qwest believes should be treated as competitive. Qwest's filing should, at a minimum, contain all of the information required by R14-2-1108 broken down to the zip code level where possible. Specifically, Qwest should provide the number of UNE and resale lines broken down by CLEC in each zip code for which it is seeking competitive classification. Because Qwest can only estimate the number of pure facilities based CLEC lines it is better to get that information from the CLECs directly. All Arizona CLECs who have CC&N's allowing them to provide facilities based service should be required to provide the number of pure facilities based lines and customers they are serving in each zip code for which Qwest is seeking competitive classification. All of the above information should be broken down by business and residence customers. Any Arizona CLEC impacted by Qwest's

Competitive Zone proposal which desires to comment on Qwest's proposal should be allowed to participate in the proceeding.

Upon receipt of Qwest's filing, Staff will make its recommendation to the Commission within 120 days. Should Qwest's filing not comply with R14-2-1108 or any Commission requirements, Staff will issue a notice of deficiency within 14 days and the 120 day time clock will be suspended until Staff deems Qwest's filing as sufficient.

**Q. Why does Staff believe that information on Competitive Zones should be broken down based on residential and business services?**

A. Staff believes that the business and residential markets for telecommunications services are fundamentally different. Competitive conditions in these markets may be quite different. In some areas, competitive classification may be appropriate for business customers only.

**Q. Why does Staff believe a sufficiency review of Qwest's R14-2-1108 filing is necessary when no such sufficiency review is conducted when CLECs make filings under R14-2-1108?**

A. Because Qwest is the dominant provider of wire line telecommunications service in its service territory, Staff believes the analysis of its R14-2-1108 filing needs to be exceptionally thorough. Since individual CLECs typically have very few customers relative to the market as a whole and their level of investment in infrastructure is typically quite small relative to the market as a whole, it is very unlikely that they will have the ability to influence the market price for telecommunications service in any meaningful way. The same can not be said for Qwest. Additionally, with a standard R14-2-1108 case Staff is not bound by the 120 day time clock it is proposing here. Thus, deficiencies can be addressed through the discovery process. With a 120 day time clock Staff and the interveners will need as much of the information as possible provided by Qwest with its filing in order to ensure timely processing.

**Q. What advantages are there to determining which zip codes should be classified as Competitive Zones in a separate proceeding?**

A. First, a second proceeding will allow Staff and the parties to sort out the data problems regarding pure facilities based providers mentioned above and discussed in detail in Staff witness Fimbres' testimony. Staff believes that an informed decision regarding which areas really are competitive should be based on accurate data. Second, a seperate proceeding will allow Staff and the parties to incorporate any feedback the Commission has to offer regarding the pending proceeding into their analysis and recommendations.

**Q. If the Commission determines to use geographic areas other than zip codes, what recommendations does Staff have regarding such a determination?**

A. Staff's primary recommendation is to base Competitive Zones on zip codes and to make those determinations in a separate proceeding. However, whether the Commission uses wire centers, zip codes or some other option as the geographic area the R14-2-1108 criteria should form the basis of any finding. Qwest did not use the R-14-2-1108 criteria in its identification of wire centers for Competitive Zone classification. Staff believes that Qwest's limited criteria produced many Competitive Zone designations that are not appropriate.

**Q. Does Staff have any other recommendations regarding Competitive Zones?**

A. Yes. In order to prevent Qwest from pricing services at unfairly low rates Staff recommends that all prices for services within Competitive Zones must exceed the TSLRIC of each service and Qwest must comply with the imputation requirements of

A.A.C. R14-2-1310(C) within Competitive Zones. In addition, the price floor for 1FR and 1FB service should exceed the highest existing applicable UNE-P rate.[21]

## IV. Arizona Universal Service Fund Issues

**Q. What is the purpose of your testimony on Arizona Universal Service Fund (AUSF) issues?**

A. Staff witness Thomas Regan will address the revenue requirements aspect of Qwest's AUSF proposal. My testimony will address Qwest's contention that their AUSF proposal will enhance the prospects for competition in rural areas.[22]

**Q. Does Staff believe that Qwest's AUSF proposal will result in increased competition in rural Arizona?**

A. The Company has failed to conclusiovely demonstrate that their proposal will result in increased competitive options for consumers in rural areas therefore, Staff believes it is inappropriate to tax ratepayers based upon Qwest's speculations. Rule R14-2-1206(E) requires that AUSF funding be portable to an ILEC's competitors. That is, if an ILEC is receiving AUSF support in a particular area and it loses a customer to a CLEC, then the CLEC would receive the AUSF support attributable to that customer. Because the rural parts of Qwest's service territory tend to be in UNE zones 2 and 3, the UNE rates in Qwest's rural areas tend to be high. These high UNE rates have been cited as a barrier to competitive entry in rural areas. Thus, AUSF support for those areas would lower the costs for CLECs who wish to compete in rural areas. Theoretically, it makes sense that lower costs would be beneficial for CLECs in rural areas; however, Staff has been unable to find any factual evidence supporting the contention that providing AUSF support to

[21] If the UNE-P product, or a product substantially similar to UNE-P, should be offered under a different name this requirement should still be binding.
[22] Shooshan p. 18 lines 10-15 and Ziegler p. 13 lines 5-7

Qwest will enhance competition. Also, factors other than costs (e.g., potential revenue) likely influence a CLECs decision to provide service in a particular area.

**Q. What investigation did Staff do regarding the likelihood that AUSF support in Qwest's rural areas would result in increased competition in those areas?**

A. Staff sent a data request (STF 2-1) to all Arizona certificated CLECs asking whether they are receiving state universal service funding in any other state and if so they were asked to identify the relevant states. The vast majority of CLECs reported that they are not receiving any universal service funding of any kind. A small number of CLECs indicated that they are receiving state universal service funding in a few states. The states identified by these CLECs are Texas, Pennsylvania, Illinois, Wyoming, Nebraska, and Kansas.[23] Staff contacted each of these states' public utilities commissions and asked a series of questions regarding the states' universal service funds and rural competition. None of these states reported that their state universal service funds were intended to promote local competition. Nebraska reported that there is a substantial amount of UNE-P based competition in its rural areas. None of the other states reported significant amounts of rural competition.

**Q. Did Qwest provide any factual evidence regarding the impact of AUSF on competition in rural areas?**

A. No.

**Q. What factors other than costs would effect a CLECs decision to compete in rural areas?**

A. Revenues. The revenue opportunities in rural areas may be substantially different than those in urban areas.

**Q. Do the Commission's rules place any restrictions on CLECs obtaining AUSF support that may be relevant?**

[23] MCI also identified Michigan but when Staff contacted the Michigan Commission we were informed that Michigan does not have a state universal service fund.

A. Yes. R14-2-1206(E) requires that a CLEC receiving AUSF support must be willing to serve "all customers in the specific AUSF support area." This provision of the rules would ensure that Qwest's proposal would offer no benefits to CLECs who specialize in serving certain type of customers only.

**Q. Are the higher UNE rates in rural areas necessarily a barrier to competitive entry?**

A. Higher UNE rates certainly do not help competition. However, it is interesting to note that (according to data supplied by Qwest) in the Phoenix and Tucson areas the number of lines served by pure facilities based CLECs is more than double that served by UNE-L, UNE-P and resale based CLECs.[24] Since UNE rates in these urban areas are not particularly high, this implies that factors other than UNE costs may be impeding UNE based competition.[25]

**Q. What does Staff recommend regarding Qwest's AUSF proposal?**

A. Staff witness Thomas Regan will sponsor Staff's primary recommendation regarding Qwest's AUSF proposal. The purpose of my testimony is to point out that the affect of Qwest's AUSF proposal on competition in rural areas is, at best, uncertain. Additionally, Staff recommends that any additional federal or state universal service funding received by Qwest during the term of the Revised Price Cap Plan be considered an adjustment to the price caps established under the plan.

## V. Deregulation of Voicemail

**Q. Has Qwest petitioned the Commission to deregulate Voice Messaging Service?**

[24] Derived from Qwest response to RUCO data requests 2.28 a –f and 2.38.
[25] The current UNE rates were established in Decision No. 64922 on June 12, 2002. Prior to that Qwest's Arizona UNE rates were considerably higher.

A. Yes. Qwest has previously filed a petition to deregulate voice messaging service (Docket No. T-01051A-98-0575) and has reiterated this request in its amended application for renewed price regulation plan (Docket No. T-01051B-03-0454 and T-00000D-00-0672).

**Q. What is the basis for Qwest's petition?**

A. Qwest has petitioned the Commission to deregulate voice messaging pursuant to A.R.S. 40-281(E) which states: "When the commission determines after notice and hearing that any product or service of a telecommunications corporation is neither essential nor integral to the public service rendered by such corporation, it shall declare that such product or service is not subject to regulation by the commission."

**Q. How does Qwest support its position?**

A. According to Qwest, the voice messaging service it offers does not constitute "transmitting messages or furnishing public telegraph or telephone service", and is in fact "totally independent of basic telephone service."[26] Further, Qwest asserts that voice messaging service is not essential or integral to basic telephone service because "basic telephone service can be and is provided to residential and business customers irrespective of voice messaging."[27]

**Q. What factors have you considered in evaluating Qwest's petition to deregulate voice messaging service?**

A. Pursuant to *Mountain States Telephone and Telegraph Co. v. Arizona Corporation Commission*, 132 Ariz. 109, 644 P.2d 263 (App. 1982), when determining whether or not to deregulate voice messaging service, the Commission must determine if the service is essential and integral to the public service rendered by the provider.

**Q. Are there any prior Commission decisions to help guide the Commission in this matter?**

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[26] US West Communications, Inc.'s Petition for Deregulation of its Voice Messaging Service, September 25, 1998 – T-01051A-98-0575 at ¶ 3

[27] US West Communications, Inc.'s Petition for Deregulation of its Voice Messaging Service, September 25, 1998 – T-01051A-98-0575 at ¶ 4

A. Yes. In 1986, Mountain States Telephone and Telegraph filed an application for deregulation and withdrawal of filed tariffs relating to the mobile radio common carrier industry. In its order granting the company's petition to deregulate radio telephone services (Decision No. 55633), the Commission relied on several factors in rendering its decision.

Staff recommended that a service be considered essential and integral if it "is judged to be indispensable or is expected to be widely available."[28]

The Commission noted that mobile radio is very specialized in nature and "the network providing this service is discrete and separable from the public telecommunications network."[29]

In addition, the following findings of fact (among others) lead to the Commission's decision to grant Mountain Bell's application to deregulate mobile radio:

a. Mobile Radio is provided through a network that is discrete and separable from the public telecommunications network.

b. Mobile Radio has been successfully provided as a matter of private contract for very specialized needs.

c. Mobile radio common carriers are not providing a public service.[30]

**Q: How does the Mountain States Telephone and Telegraph decision help to guide your analysis of the petition to deregulate voice messaging service?**

A: Staff has utilized the test for the essential and integral nature of a service from the Mountain Bell decision as a basis to determine that voice messaging service is not essential and integral to the provision of the public service rendered by Qwest. Secondly, voice messaging service meets several of the criteria used by the Commission in rendering Decision No. 52633 in the Mountain States case. Voice messaging service is discrete and

[28] Decision No. 55633, Docket No. E-1051-86-016, July 2, 1987, page 4 line 18.
[29] Decision No. 55633, Docket No. E-1051-86-016, July 2, 1987, page 6 line 9.
[30] Docket No. E-1051-86-016, July 2, 1987, pages 8-9.

separable from the public telecommunications network. It has been successfully provided as a matter of private contract, and voice messaging businesses are not providing a public service.

**Q: Please describe the factors that lead to this conclusion.**

A: There are many examples of competitive providers offering voice messaging service in the marketplace. In its letter dated July 9, 2002, Qwest provided a supplemental list of alternate voice message providers listed in the DexOnline Yellow Pages that included more than fifty (50) companies. The majority of these companies are unregulated businesses that are not engaged in furnishing public telephone service.

**Q: Does Staff find that Qwest's voice messaging service is indispensable?**

A: No. Voice messaging service or close substitutes are expected to be, and are, widely available in the market. Along with the list of more than fifty competitive voice mail providers in Arizona, answering machines and answering services also serve as close substitutes for voice messaging service. Qwest has indicated that of its voice messaging service capable lines, approximately 25% of residential lines and 28% of business lines subscribe to the service. These numbers indicate that either voice messaging service is not indispensable to customers, or there are sufficient substitutes available to cover the messaging requirements of nearly three-quarters of Qwest's voice messaging capable phone lines.

**Q: Did Staff perform an analysis to determine whether voice messaging service is a public service pursuant to Article 15 § 2 of the Arizona Constitution?**

A: Yes. In determining whether Voice Messaging Service is a public service pursuant to Article 15 § 2, Staff has examined the relationship between voice messaging service and the public switched telephone network. While the provision of voice messaging service requires some elements of the public switched telephone network such as the call forwarding busy line/don't answer features on the customer's line and an interconnection between the central office and voice response unit (considered by Qwest to be Customer Premise Equipment), the public telephone network can and does operate properly whether or not voice messaging service is being provided.

**Q: Is it possible for a company to provide voice messaging service without owning any facilities that would be considered elements of the public switched telephone network?**

A: Yes. Many non-regulated voice mail providers are able to offer the service using a combination of their own voice mail platform and tariffed network services from a facilities-based local exchange company. Some competitive local exchange carriers such as MCI, SBC, and AT&T outsource their voice mail platforms.

**Q: In general, can you describe the manner in which non-regulated companies provide voice messaging service?**

A: Qwest's list of alternative voice mail providers shows a multitude of non-regulated companies that offer voice messaging service. Several of these companies provided a description of the equipment and public switched telephone network facilities necessary for them to provide voice messaging service.

Competitive voice messaging providers typically own or sub-contract the voice mail platform, own or lease various network facilities, and purchase various tariffed services from a local exchange carrier. The voice mail platform or voice response unit handles the voice messaging transactions such as recording, storing, and playing messages, and notifying the customer of new messages. Calls are terminated to the voice mail platform. The competitive provider can own or lease varying degrees of equipment and facilities above and beyond the voice mail platform. This determines the network services it must purchase at standard tariffed rates from the local exchange carrier. However, certain basic service elements are required from the LEC such as the Multi Line Hunt Group feature, Message Delivery Service, and the Message Waiting Indicator. In addition, the customer must have call forwarding features from its LEC to forward missed calls on to the voice mail platform via the public switched telephone network.

**Q: Does the existence of these types of non-regulated providers help you to determine whether voice messaging service is a public service?**

A: Yes. The abundance of non-regulated providers of voice messaging service is evidence that this feature is discrete and separable from the public switched telephone network. Voice messaging businesses are not providing a public service.

**Q. Does the availability of answering machines affect the decision regarding voice mail deregulation?**

A. Yes. Modern answering machines are close substitutes for voice mail service and are widely available and their prices are unregulated.

**Q: What is your recommendation with respect to Qwest's petition to deregulate voice messaging service?**

A: Based on the findings that voice messaging service is not essential and integral to basic telephone service, that it is discrete and separable from the public switched telephone network and that it is subject to private contracts; Staff recommends that the Commission grant Qwest's petition to deregulate voice messaging service. Staff also recommends that Qwest's pending application to deregulate voicemail (Docket No. T-01051A-98-0575) be closed. Pursuant to *Mountain States Telephone and Telegraph Co. v. Arizona Corporation Commission*, 132 Ariz. 109, 644 P.2d 263 (App. 1982), the Commission should reserve the right to ensure that voice messaging service is offered in a non-discriminatory fashion and that the service does not result in the evasion or frustration of the Commission's regulation of telephone service.

## VI. Deregulation of Billing and Collection

**Q. What has Qwest requested with respect to its Billing and Collection ("B&C") Services?**

A. Qwest has requested that its B&C Services (referred to as "Information and Billing Services" in Qwest's Access Service Price Cap tariff) be deregulated.

**Q. What is B&C Service?**

A. B&C Service provides Access Service customers (IXCs) with billing, collection and information services. The services include the following:

- Recording – Records the information for calls that is necessary to bill customers for calls that have been made.
- Message Based Billing – Provides for the billing of customers for individual calls that they have completed. Services include usage sensitive toll services.
- Non-Message Based Billing - Provides for the billing of customers for services that they have received that are non-usage sensitive. Services include non-usage sensitive services such as private line services.
- Billing Analysis – Provides for the detection, investigation and deterrence of billing evasion activities.
  End User Account Activity – Provides for changes, adds or deletions to an end user's account information.
- Message Investigation – Provides for the investigation of calls that are disputed.
- Billing Information – Provides for the forwarding of end user records billing files and account data to the customer.
- Media Provisioning - Applies to the charges for the manner in which data is provided to the customer. Charges vary depending upon whether the medium used is magnetic tape, cartridges, data transmission, microfiche and the type of delivery methods requested.
- Ancillary Offerings – includes Market Messages, Screen Bill Fiche and Billing Name and address
- CARE/ISI – Provides for the ability to exchange information in the CARE/ISI format.
- Custom Request and Consulting – Services that are provided in response to a customer's special request.

**Q. What is the current pricing regime for Qwest's B&C Service?**

A. Currently, Qwest's B&C Service is provided as a flexibly priced service with maximum rates in Qwest's Access Service tariff. The current rates for services (other than ICB priced services) are contained in a price list.

**Q. Describe the Billing and Collection service that Qwest proposes to deregulate.**

A. Qwest proposes to deregulate all of the services currently contained in its Information and Billing Services tariff.

**Q. Who are the alternative providers of B&C Service identified by Qwest?**

A. In its response to Staff Data Request Nos. 30-14 and 30-15, Qwest indicated that carriers' own billing systems, major credit card companies, bill aggregators or other major direct billing providers are alternatives to Qwest-provided Billing and Collections, Market Message, End-User Inquiries, Custom Services and Consulting Services. Further, Qwest responded that IXCs' switches have the capability to record call detail information and that IXCs have the ability to take that call detail and determine the charges for their services.

**Q. Has the Federal Communications Commission ("FCC") issued any decision on Billing and Collection Service?**

A. Yes. In 1986, the FCC detariffed B&C Service.[31]

**Q. What is the current regulatory status of Billing and Collection Service in the Qwest region?**

A. In response to Staff Data Request No. 30-16, Qwest indicated that B&C has been deregulated in 8 of the 14 states in its region. Further, the service has been classified as competitive in 4 states with significant pricing flexibility, and that the service is "tariffed" in New Mexico.

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[31] See Detariffing of Billing and Collection Services, CC Docket No. 85-88, 102 FCC 2d 1150 (1986) (Billing and Collection Detariffing Order) recon. denied, 1 FCC Rcd 445 (1986).

**Q. Who are the alternative providers of Billing and Collection Service that Qwest proposes to deregulate**

A. In its response to Staff Data Request Nos. 30-12 and 30-13, Qwest indicated that the following companies currently provide alternatives to Qwest-provided B&C Services:

* * * Confidential * * *
[redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted][redacted]
* * * Confidential * * *

**Q. Did you request information from IXCs and CLECs regarding B&C Service?**

A. Yes.

**Q. Were you able to reach any conclusions based on their responses to Staff's data requests?**

A. Yes. The majority of the respondents to Staff's Data Request indicated that they do not subscribe to or use any of Qwest's B&C Services. Some of the respondents indicated that they use Qwest B&C Service for at least part of their B&C needs. These responses indicate that B&C is not a service that can only be provided by Qwest. IXCs and CLECs have various alternatives. They can use their own equipment entirely or use a combination of their networks and services provided by others or rely entirely on others for B&C services. Based on these factors B&C service is not essential and integral to the provision of telephone service.

**Q. What is you recommendation with respect to Qwest's proposal to deregulate B&C Service?**

A. I recommend that the Commission approve Qwest's proposal to deregulate B&C Service. Pursuant to *Mountain States Telephone and Telegraph Co. v. Arizona Corporation Commission*, 132 Ariz. 109, 644 P.2d 263 (App. 1982), the Commission should reserve the right to ensure that voice messaging service is offered in a non-discriminatory fashion and that the service does not result in the evasion or frustration of the Commission's regulation of telephone service.

## VII. Promotions

**Q. Please describe Qwest's current Promotional Offering Tariff.**

A. Qwest's current Promotional Tariff Offering allows the Company to engage in promotions from time to time. Under the terms of the tariff the promotions are designed to attract new customers or increase awareness of its offering. In addition the tariff states that the promotions will be designed to cover the marginal cost of the promotion. Qwest is required to provide 30 days notice to Staff if promotions are valued at greater than $25.00 per customer. Finally, Qwest must provide concurrent notification to Staff of promotions valued at less than $25.00 per customer and is required to report the results of the promotion to Commission Staff.

**Q. What is Qwest's proposal regarding changes to its promotions tariff?**

A. Qwest proposed to amend its Promotional Offering tariff such that it is not required to provide 30 days notice to Staff if promotions are valued at greater than $25.00 per customer. Additionally, Qwest proposes to eliminate the requirement that the promotional prices cover the marginal cost of the relevant services.

**Q. Do any CLECs or IXCs have the sort of promotional offering flexibility the Qwest is requesting in this proceeding?**

A. Yes. A number of CLECs and IXCs have general language in their tariffs that allow the companies to offer promotions that include, but are not limited to, rate discounts or waivers of non-recurring charges from time to time. This is the predominate approach.

**Q. Do all CLECs and IXCs have the sort of promotional offering flexibility that Qwest is requesting in this proceeding?**

A. No. Tariffs that apply to CLEC and IXC promotions vary depending on the language in their tariffs. Some file individual promotions that become effective on 30 days notice to the Commission because these promotions are filed as tariff revisions. Others include language in their tariff that requires them to file promotions with the Commission before they can become effective.

**Q. What is Staff's recommendation on the proposal to grant Qwest additional flexibility regarding promotions?**

A. Staff recommends that Qwest's proposal eliminating the requirement that Qwest's promotions be filed with the Commission 30 days prior to going into effect be approved. However, Qwest should be required to file promotions with the Commission concurrent with their effective dates. Also, Staff does not believe it is appropriate to end the requirement that promotional prices must cover marginal cost. The requirement that prices cover marginal cost is an important safeguard against anti-competitive behavior.[32]

## VIII. Term of the Revised Price Cap Plan

**Q. What term does Staff believe the Revised Price Cap Plan should have?**

A. Staff believes a term of three years is appropriate. Nine months prior to the end of the three year period Qwest should file an application to renew, revise, or cancel the Revised Price Cap Plan. The Revised Price Cap Plan should remain in effect until the Commission issues an order that changes its terms. The three year period should begin upon Commission approval of the plan in this case.

**Q. Should Qwest be precluded from making an application to revise or cancel the Revised Price Cap Plan during the three year term?**

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[32] Staff clarifies that the marginal cost test for a promotion should cover the entire term of the promotion. For example, if Qwest offers a discounted rate for two months in exchange for a two year commitment to a particular service, the marginal cost test should take into account all costs and revenues over the two year period.

A. No. Because competitive conditions may change Staff believes it is appropriate to allow Qwest and the Commission to open a review of the Revised Price Cap Plan if competitive conditions warrant. This would allow both Qwest and the Commission the flexibility necessary to address unforeseen problems that may result from the Revised Price Cap Plan.

**Q. What reporting requirements does Staff recommend be imposed on Qwest during the term of the plan?**

A. Staff recommends that Qwest be required to file annual reports that document the price changes that have taken places over a given year and that verify that Qwest is complying with the revenue caps established in this proceeding. These reports should be filed by the end of April for each year the Revised Price Cap Plan is in effect. Also, Staff Witness Brosch describes additional recommended reporting requirements in his testimony.

## IX. UNE-P Availability and Other Competitive Issues

**Q. What is UNE-P?**

A. UNE-P is a wholesale product that bundles all of the network elements necessary to provide end users with local service (including switching.) The UNE-P product is functionally similar to the Resale of local exchange service. One important difference between UNE-P and Resale is the treatment of access charges. When a CLEC enters into a Resale agreement with Qwest (or any other ILEC), the CLEC has no claim to the access charges associated with its end users' long distance traffic. With Resale the ILEC keeps the access charges. Conversely, when a CLEC leases the UNE-P product from Qwest, the CLEC receives the access revenues.

**Q. What is the current status of UNE-P?**

A. Currently Qwest is providing UNE-P to CLECs with an existing interconnection agreement under TELRIC rates approved by the Commission (at least until year end.) However, the future status of UNE-P has been called into question by the Federal

Communications Commission's ("FCC") *Interim Unbundling Order.*[33] In its Order, the FCC put in place an interim plan which applies to the transition period before it adopts final unbundling rules and issued a Notice of Proposed Rulemaking seeking comment on final rules. Staff believes that, based on the *Interim Unbundling Order,* it is likely that the final rules will do away with the requirement that UNE-P be provided at Commission approved TELRIC rates, at least in certain markets.

Qwest indicated to Staff that it has already stopped offering UNE-P at TELRIC rates to new CLECs based upon paragraph 22 of the *Interim Unbundling Order.* Qwest has also indicated that it is offering a new product that is functionally equivalent to UNE-P it calls Qwest Platform Plus. The price of Qwest Platform Plus is the same as that for UNE-P until the end of this year but will then ratchet up in January of 2005, in January of 2006, and again in January 2007.[34]

**Q. Currently how many CLEC customers are served through UNE-P?**

A. UNE-P currently makes up a significant but not overwhelming portion of total CLEC lines. The following table shows the composition of lines currently served by CLECs:

**Table 8**

| Percent of Total CLEC Lines[35] | |
|---|---|
| **UNE-L** | **5%** |
| **UNE-P** | **27%** |
| **Resale** | **1%** |
| **Private Line Resale** | **0.02%** |
| **UNE-L with EEL** | **0.3%** |
| **Full Bypass** | **67%** |

[33] *In the Matter of Unbundled Access to Network Elements and Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Docket No. 04-313 and CC Docket No. 01-0338, Order and Notice of Proposed Rulemaking (Released August 20, 2004)("*Interim Unbundling Order*").
[34] Qwest response to Cox data request 2-18.
[35] Response to RUCO data requests 2.28A through 2.28F, and 2.38, Full bypass numbers based on Qwest's *estimate.*

**Q. Is the elimination of Commission approved rates for UNE-P more likely to affect business or residential customers?**

A. UNE-P has been used primarily to serve residential customers. With the exception of Cox, all CLECs with significant numbers of residential customers have primarily used UNE-P to serve those customers. With the elimination of economic rates for UNE-P, Cox is likely to be left as the only CLEC serving significant numbers of residential customers. The market for traditional residential wire line service is likely to be a duopoly in that event.

**Q. What are the implications of this duopoly market structure?**

A. A duopoly market structure (and more generally an oligopoly market structure) is of concern to economists because with a small number of firms the potential for collusion (either explicit or tacit) is enhanced. Such collusion could keep prices above competitive levels to the detriment of consumers. However, it is not known whether such collusion will actually take place. Staff is not aware of any indications at this time of any collusive activity. There are highly concentrated industries that are not characterized by collusion and supra competitive prices (e.g., Boeing and Airbus are the only two manufactures of large commercial aircraft in the world and that market is generally regarding as competitive.) The degree to which concentration affects competitiveness varies from industry to industry.

**Q. How would the above comments on concentration in the residential market change if other forms of competition such as wireless and VOIP are taken into consideration?**

A. If wireless were to become an acceptable substitute for wire line service for most residential consumers, then the residential market would look less concentrated. Currently, Staff does not believe that wireless is a true substitute for wire line service.

Staff believes it is too early to determine the ultimate effect of VOIP. While many commentators tout VOIP as a technology that could bring wide spread competition to the wire line market, it should be remembered that many commentators felt the same way about UNE based competition in the years shortly after the 1996 Act was passed. Also, VOIP is only available to customers who also purchase a broadband connection.

**Q. How is the Arizona market for business wire line telecommunications service different from the residential market?**

A. There are many more CLECs providing business service then there are providing residential service. However, the overwhelming majority of business customers are still being served by Qwest.

Elimination of Commission approved pricing for UNE-P will have much less of an impact on the business market then it will on the residential market. UNE-P is not heavily depended on by CLECs serving business customers.

While in the residential market use of the UNE Loop ("UNE-L") is almost non existent, CLECs serving business customers are much more likely to use UNE-L. However, the number of business customers served through UNE-L is still not impressive even now, almost nine years after the 96 Act was passed.

There are CLECs who provide pure facilities based service to businesses. However, their numbers are not large and, with the exception of Cox, they are unlikely to be able to offer pure facilities based service to the full spectrum of potential business customers.

**Q. Is there a particular reason why UNE-L based competition has not become more prevalent?**

A. In its Triennial Review Order ("TRO") the FCC found that ILECs cannot handle the volume of UNE-L conversions necessary to serve the mass market.[36] A UNE-L conversion is the process of lifting a loop from the ILECs switch and then connecting it to a CLEC's switch.[37] This is a labor-intensive process that involves skilled technicians working in what can be confined conditions. In order to comply with the requirements of the TRO Qwest was developing, through a collaborative process, a Batch Hot Cut process to facilitate high volumes of UNE-L conversions. However, that collaborative process was never completed. Before the collaborative process on Batch Hot Cuts was abandoned Qwest and the CLECs had reached agreement on many issues and their impasse issues had been referred to the state commissions for resolution.

**Q. Why was the Batch Hot Cut Process never completed?**

A. The Commission (and most, if not all, other state Commissions) suspended its TRO proceeding after the United States Court of Appeals, D.C. Circuit issued its March 2, 2004 decision that vacated substantial portions of the TRO.

**Q. Does the fact that the D.C. Circuit vacated parts of the TRO affect the FCC's finding that an improved Batch Hot Cut process was necessary?**

A. No. The D.C. Circuit's decision vacated certain requirements of the TRO; it did not eliminate any of the FCC's factual conclusions.

**Q. Does Staff believe that completion of the collaborative Batch Hot Cut process would enhance the prospects of competition?**

A. Yes. An effective Batch Hot Cut Process will make UNE-L based competition much more viable. Staff recommends that as a part of this case the Commission should order Qwest to revive the collaborative Batch Hot Cut process. Qwest should be required to reconvene the members of the collaborative to determine if the status of the agreed upon and impasse issues has changed. If the collaborative determines that the status of the

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[36] TRO ¶ 459
[37] UNE-L conversions are also referred to as "hot cuts."

issues has changed additional meetings should be scheduled to come up with a revised list of resolved and impasse issues. Whether additional meetings are necessary or not all impasse issues should be submitted to the Commission for resolution.

In our testimony Staff has endorsed enhanced pricing flexibility for Qwest and elimination of the inflation/productivity factor. Both of those Staff recommendations were based on the existence of competition. In fact, the continuation of the Price Cap Plan in general is based, from Staff's perspective, on the existence of competition. Thus, Staff believes it is reasonable to include in this case conditions that will help to bolster the prospects for competition on an ongoing basis. The pro-competitive condition that Qwest implement a viable Batch Hot Cut process serves the purpose of bolstering the prospects for competition on an ongoing basis.

**Q. Does this conclude your direct testimony?**

A. Yes, it does.

**Exhibit 1**

# Price Cap Plan

(1) Baskets
  a) Basket 1: Non-competitive Services
  b) Basket 2: Wholesale Services
  c) Basket 3: Flexibly-Priced Competitive Services

(2) Basket 1: Non-competitive Services
  a) A list of the individual services in Basket 1 is appended hereto as Attachment 1
  b) Cap on Basket 1

i) The services in Attachment 1 are subject to a revenue cap specific for Basket 1 during the period of the Renewed Price Cap Plan. Revenue neutral filings for services within Basket 1 without individual caps are allowed with notice to the Commission through a tariff filing.

ii) The formula for the Price Cap Index for Basket 1 is:

$$1 \geq [\text{SUM } [P_N * Q_b]\ ] / [\text{SUM } [P_b * Q_b]\ ]$$

The numerator of the Price Cap Index of Basket 1 is the sum of the proposed/new prices multiplied by the "base year" quantities of demand. The proposed/new prices will be calculated using weighted averages of the prices of Basket 1 services across the Competitive Zones (and non-competitive area) as described in Section 6 below. Where price changes have not occurred, the base year price of the service is used. The denominator is the sum of base year prices multiplied by the "base year'" quantities of demand. Section *(6)* below details the data that Qwest shall provide to enable calculation and monitoring of the cap.

  c) Service Pricing Flexibility
    i) Certain Basic Services are to be capped at their initial levels throughout the term of the Price Cap Plan. These service prices may be reduced but not raised above their current levels. These services are: flat rate residential; flat rate business; exchange zone increment charges; low use option service; service stations service; telephone assistance programs; individual PBX Trunks, including features; Caller ID block; toll blocking; 900/976 blocking; and basic listing service.
    ii) The remaining services in Basket 1 may increase or decrease within the band established by the Revenue Cap.
    iii) Individual service rate elements within Basket 1, other than those services listed in subpart i) above [services subject to the hard cap], may increase no more than 25 percent within a year.
    iv) Individual service prices must exceed the service's Total Service Long Run Incremental Cost ("TSLRIC"), unless a different cost standard applicable to all telecommunications service providers is determined appropriate by

the Commission. Individual service prices must also comply with the imputation requirements of A.A.C. R14-2-1310(C), as applicable.

v) Changes to Terms and Conditions of services in Basket 1 shall be submitted to the Commission for Staff review and approval. All services in Basket 1 shall be continued statewide at the tariffed rate, unless or until the Commission orders retail geographic rate de-averaging, or unless Qwest demonstrates a cost difference for a new service on which to base the price difference, or unless the Commission designates areas as Competitive Zones as discussed below. Nothing in this Price Cap Plan shall preclude the Commission from deaveraging wholesale rates on a cost basis.

vi) Price increases for services in this Basket require 30 day notice to the Commission by submission to Staff, and 30 days notice to consumers.

(3) Basket 2: Wholesale Services

a. The services included in Basket 2 at the Renewed Price Cap Plan's inception include: Intrastate Carrier Switched Access, Discounted Wholesale Offerings, Unbundled Network Element (UNE) Offerings, Wholesale services such as PAL lines, and all other wholesale offerings unless specifically listed in Attachments 1 and 3 as included in either Basket 1 or 3. A list of wholesale services, with the exception of UNEs included in Basket 2 at the Price Cap Plan's inception is contained in Attachment 2.

b) Basket 2 consists of wholesale services many of which are governed by their own specific pricing rules and will continue to be governed by such rules as interpreted by the Commission and the Courts, under this Price Cap Plan,
c) UNEs and discounted Wholesale Offerings are priced based on the provisions of the Telecommunications Act of 1996 (1996 Act), FCC implementing regulations and Commission rules.
d) Intrastate Switched Access Services are to be reduced by $8.9 million upon implementation of the Renewed Price Cap Plan.
e) Service prices are capped for the term of the Renewed Price Cap Plan, or until the specific pricing rules are changed or the Commission determines that other prices are appropriate.
f) New wholesale services are to be added to this Basket when those services are implemented.

(4) Basket 3: Flexibly-Priced Competitive Services

a) This Basket includes only those services that have been accorded pricing flexibility or have been determined by the Commission to be competitive under A.A.C. R14-2-1108, and new services and new service packages offered by Qwest. Any new services and new service packages offered by Qwest shall be subject to the prior review and approval of the Commission, as provided in subpart e) below. A list of services included in Basket 3 at the inception of this Price Cap Plan is appended hereto as Attachment 3.
b) The revenue cap for Basket 3 is the weighted average price level of all the services in the Basket as calculated by the formula set forth in subpart c) following, subject to annual updates in quantities. Notwithstanding, the additional revenue level for purposes of headroom in Basket 3, shall be capped.
c) The formula for calculating the Price Cap Index for Basket 3 is:

$$1.0 \geq [SUM\ (Pn * Qb)] / [SUM\ (1.XX * Pb * Qb)]$$

The numerator is the sum of the proposed or new prices multiplied by the "base year" demand. The proposed/new prices will be calculated using weighted averages of the prices of Basket 3 services across the Competitive Zones (and non-competitive area) as described in Section 6 below. Where price changes have not occurred, the base year price of the service is used. The denominator is the sum of one hundred XX percent of the base year prices multiplied by base year demand. Pb and Qb are the prices and quantities of services in the basket in the "base" year of the plan. For new services and the packages Pb and Qb are the prices and quantities for the first full year the service is offered. See 4(d) below for further explanation of the appropriate data to be used for new services and packages. The XX% increase allowed under the Price Cap Index for Basket 3 is for the term of the Price Cap Plan.

d) New services and service packages shall be added to the calculation of the price cap index, in both the numerator and denominator, at the end of the year in which they were introduced, to obtain actual experience with the service, so the calculation is not based solely upon projections. Qwest shall provide notification to Staff of the new services/packages and their prices as provided in subpart (e) below. Once a full year's worth of actual demand is available for use in the Revised Price Cap Plan that demand should be the "base" year demand to be used,

e) Any services in Basket 1 may be the components of any new package that would be offered in Basket 3. Each Basket 1 service that is included in a package offered in Basket 3 shall continue to be offered in its current form in Basket 1 as of' the commencement of the Price Cap Plan.

f) The price of all packages containing Basket 1 services shall be hard-capped at the sum of the ala-carte prices of the services contained in the package.

g) Any new services proposed to be included in Basket 3, shall be submitted at least thirty days in advance of the proposed effective date of the tariff of the new package or service and shall be subject to Commission consideration as provided in A.R.S. §40-250. The Commission retains the right to reject any proposed classification or filing. The price of the new package or service shall exceed the TSLRIC of the package or service and comply with the imputation requirements of A.A.C. R14-2-1310 (c).
   i) Qwest shall be required to inform consumers, through its marketing of such new packages, including through its bill inserts, educational materials and customer representative scripts, that the services in Basket 1 remain available and can continue to be purchased as separate offerings.
   ii) The mere repackaging of existing Basket 1 services does not create a "new service" or "new service package" for purposes of the Price Cap Plan.

h) Individual service and package prices must provide revenues in excess of the service's or package's TSLRIC subject to the provisions of subpart e) above, unless a different cost standard applicable to all telecommunications service providers is determined appropriate by the Commission. The individual service and package prices must also comply with the imputation requirements of A.A.C. R14-2-1310(c).

i) Existing services in Basket 3 shall continue to be offered to existing customers. Qwest must receive Commission approval for discontinuation or revision of services, terms and conditions.

   i) Basket 1 service may be moved to Basket 3 upon Qwest meeting the criteria of A.A.C. R14-2-1108. Staff will process such an Application as expeditiously and thoroughly as possible and, in any event, will complete such processing within a period of six months, unless another time period is agreed to by Qwest or the six month time period is waived by the Commission.

k) If a service is moved from Basket 1 to Basket 3 because it has met the criteria of R 4-2-1108, the Basket 3 price and quantities for the numerator and the denominator for that service shall be the prices and quantities for that service contained in the numerator of the Basket 1 PCI formula at the time that the service is moved, and the 1.XX factor will not be applied to these services for the remaining term of the plan. The Commission's existing rules (A.A.C. R14-2-1109) which prohibit cross-subsidization of competitive services (Basket 3) by non-competitive services (Baskets 1 and 2) shall continue to apply to all services offered by the Company under this Price Cap Plan.

m) Price changes to flexibly priced and competitive services contained in Basket 3 shall comply with the requirements of A.A.C. R14-2-1109.

*(5)* Competitive Zones

a) Qwest can request Competitive Zone classification for selected zip codes[1]. An application for Competitive Zone treatment shall be processed in accordance with A.A.C. R14-2-1108 and shall contain at a minimum the following information:

   i) All of the information required by R14-2-1108 broken down to the zip code level for each zip code for which it is seeking competitive classification.
   ii) Specifically, Qwest shall provide the number of UNE and resale lines broken down by CLEC in each zip code for which it is seeking competitive classification.
   iii) All of the above information should be broken down by business and residence customers.
   iv) If Qwest is unable to provide the number of UNE and resale lines broken down by CLEC in each zip code for which it is seeking competitive classification, the Commission shall have the right to order all CLECs to provide such information.

b) Because Qwest can only estimate the number of pure facilities based CLEC lines that information must be obtained from the CLECs directly. All Arizona CLECs who have CC&Ns allowing them to provide facilities based service should be required to provide the number of pure facilities based lines and customers they are serving in each zip code for which Qwest is seeking competitive classification. All of the above information should be broken down by business and residence customers.

c) Qwest will file with Staff, in electronic form, an Excel spreadsheet that contains all relevant competitive information as described in 5.a and 5.b above.

c) Staff will determine the sufficiency of Qwest's Competitive Zone classification application within 14 days.

d) Staff will complete its analysis of Qwest's Competitive Zone classification application within 120 days from the date Qwest's application is deemed sufficient.

e) Any interested person or party may intervene in a proceeding brought by Qwest for Competitive Zone Classification. Any party may request a hearing on

[1] Unless otherwise specifically noted in this document or changed by Commission order, use of the term zip code should be understood to mean service address zip code, not billing address zip code.

Qwest's application within 60 days from the date the application is deemed sufficient.

f) The Commission may narrow the geographic area for which competitive classification is requested to cover only the portion of the area where competition warrants.

g) Nothing precludes Qwest from requesting competitive classification of areas or developments within a zip code, however, Qwest must still provide all of the information required under these rules for competitive classification.

h) Services in Competitive Zones can be priced differently than the same services outside of Competitive Zones and can be priced differently across the different Competitive Zones subject to the following conditions:
  i) Maximum Rates for all services in Competitive Zones must be included in Qwest's tariffs.
  ii) Increases in Maximum Rates need to be approved by the Commission pursuant to A.A.C. R14-2-1110.
  iii) The Maximum Rates for the services listed in 2(c)(i) above will be set at their current rate (i.e., their rates as of 2004) throughout the term of the Revised Price Cap Plan.
  iv) Revenue from Basket 1 services provided in Competitive Zones will count towards the revenue cap on Basket 1.
  v) Revenue from Basket 3 services provided in Competitive Zones will count towards the revenue cap on Basket 3.
  vi) The Price Cap Indexes for Baskets 1 and 3 will be calculated using weighted averages of the prices across the Competitive Zones (and non-competitive area) as described in Section 6 below.
  vii) Individual service prices in the Competitive Zones (and non-competitive area) must exceed the service's Total Service Long Run Incremental Cost ("TSLRIC"), unless a different cost standard applicable to all telecommunications service providers is determined appropriate by the Commission. Individual service prices must also comply with the imputation requirements of A.A.C. R14-2-1310(C), as applicable. In addition, the price floor for 1FR and 1FB service should exceed the highest existing applicable UNE-P rate.[2]

i) Any interested person or party may file an application for Competitive Zone declassification. Any application for Competitive Zone declassification should include all of the criteria contained in A.A.C. R14-2-1108.

*(6)* Annual Filing of Price Cap Data

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[2] If the UNE-P product, or a product substantially similar to UNE-P, should be offered under a different name this requirement should still be binding.

a) Price Cap Database: For the first year of the Price Cap Plan, Qwest will file, in electronic form, an Excel spreadsheet that is a database of the prices and quantities of each service in Baskets 1 and 3. The spreadsheet will include the formula for calculating the index of Baskets 1 and 3. The spreadsheet format should enable the Staff to type in a price change and instantaneously observe the effect of the price change on the weighted average price level of the affected Basket. The data in the spreadsheet shall include the following columns for each Basket:

**Basket X: Denominator or Numerator Price Index**

| Service Name | Tariff Section | Date of Most Recent Price Change | Price | Quantity Demanded | Revenue |
|---|---|---|---|---|---|

The price shall be the weighted average of prices across the Competitive Zones (and non-competitive area.) Qwest will provide separate spreadsheets for each service that detail how the weighted average prices are calculated. Those spreadsheets for each service will contain at a minimum the following columns:

**Service Name: Weighted Average Price Calculation**

| Competitive Zone identifier | Price in Zone | Quantity Demanded in Zone | Revenue in Zone |
|---|---|---|---|

This data will be fixed for calculation of the Price Index denominator at each service's price at the beginning of the Price Cap year. A second set of this same data shall be included in the spreadsheet for each Basket and will be updated with each price change throughout the year, cumulatively, in order to calculate the Price Index numerator. The Index for the Basket is calculated as the ratio of the numerator data over the denominator data, as described above for each Basket. The calculated Price Index for each Basket shall remain below the Basket's assigned Price Cap in order for rate changes to be considered lawful upon filing. The spreadsheet shall be equipped with the formula that enables instantaneous verification that a price change by Qwest is within the prescribed cap.

b) The Price Cap Database shall be updated annually, reflecting end of year prices and quantities which represent existing prices and current quantities to be used in the next year of the plan.

c) As individual price changes are filed, the Staff shall examine their effect on the affected Baskets' Price Index, using the Price Cap Database. If a price change results in a Price Index above the Cap, the price change does not comply with the Plan and Staff may recommend rate reductions that should occur in order to meet the constraints of the Cap.

7) Annual Filings of Earnings Data

a) On April 1st of each year Qwest shall file a report which summarizes earnings and revenue requirements data for each calendar year. The filing shall present test period intrastate earnings and rate base results prepared on a basis of accounting consistent with ratemaking principles established by the Commission inclusive of the Commission's resolution of the following adjustments:

i) Duplication of $72 million of directory revenue
ii) Calculation of Depreciation expense / reserves at Commission approved rates.
iii) Accrual basis accounting for OPEBs.
iv) Fixed cash working capital amount.
v) SOP 98-01 accounting for software.
vi) Pension assets in rate base
vii) Exclusion of or imputation of revenues for FCC nonregulated services

8) Renewal of the Revised Price Cap Plan

a) The Revised Price Cap Plan shall have a term of 3 years at the end of which Qwest may propose to either:
   i) Renew the Price Cap Plan under the current terms and conditions; or
   ii) Renew the Price Cap Plan with proposed revisions.
b) Qwest's proposal shall be filed along with other monitoring information requested at the end of the first quarter of the third year of the Price Cap Plan. If Qwest's proposed revisions are not revenue neutral, Qwest shall also file all information required under A.A.C. R14-2-103 if Staff or the Commission determines that this information is necessary for a complete evaluation of the Plan or of Qwest's proposed modifications to the Plan.
c) Whether and under what terms and conditions to renew the Price Cap Plan may be determined by negotiations among Staff, Qwest, and other parties subject to the Commission's approval. Contested hearings on renewal of the plan may or may not occur depending on the disposition of negotiations among parties. Nothing herein, however, shall preclude any party from requesting a hearing on the Company's proposal to renew the Price Cap Plan. Nothing herein shall affect the Commission's jurisdiction or authority to determine the most appropriate form of regulation for Qwest at the end of the 3 year term of the Price Cap Plan, including termination of the Plan.

9) Applicability of Commission Rules and Orders

a) Unless expressly provided herein, this Price Cap Plan is not intended to alter or eliminate the application of current Commission rules and orders to Qwest.
b) Nothing in this Price Cap Plan is intended to change or modify in any way the imputation requirements contained in A.A.C. R14-2-1310.
c) Nothing herein is intended to in any way restrict or modify the Commission's current authority or jurisdiction over Qwest as provided under Arizona law.
d) Decision No. 63487 including the Settlement Agreement between the parties shall remain in effect except to the extent modified by the Commission in this proceeding or as modified herein.

| Attachment 1 | Basket 1 Services | |
|---|---|---|
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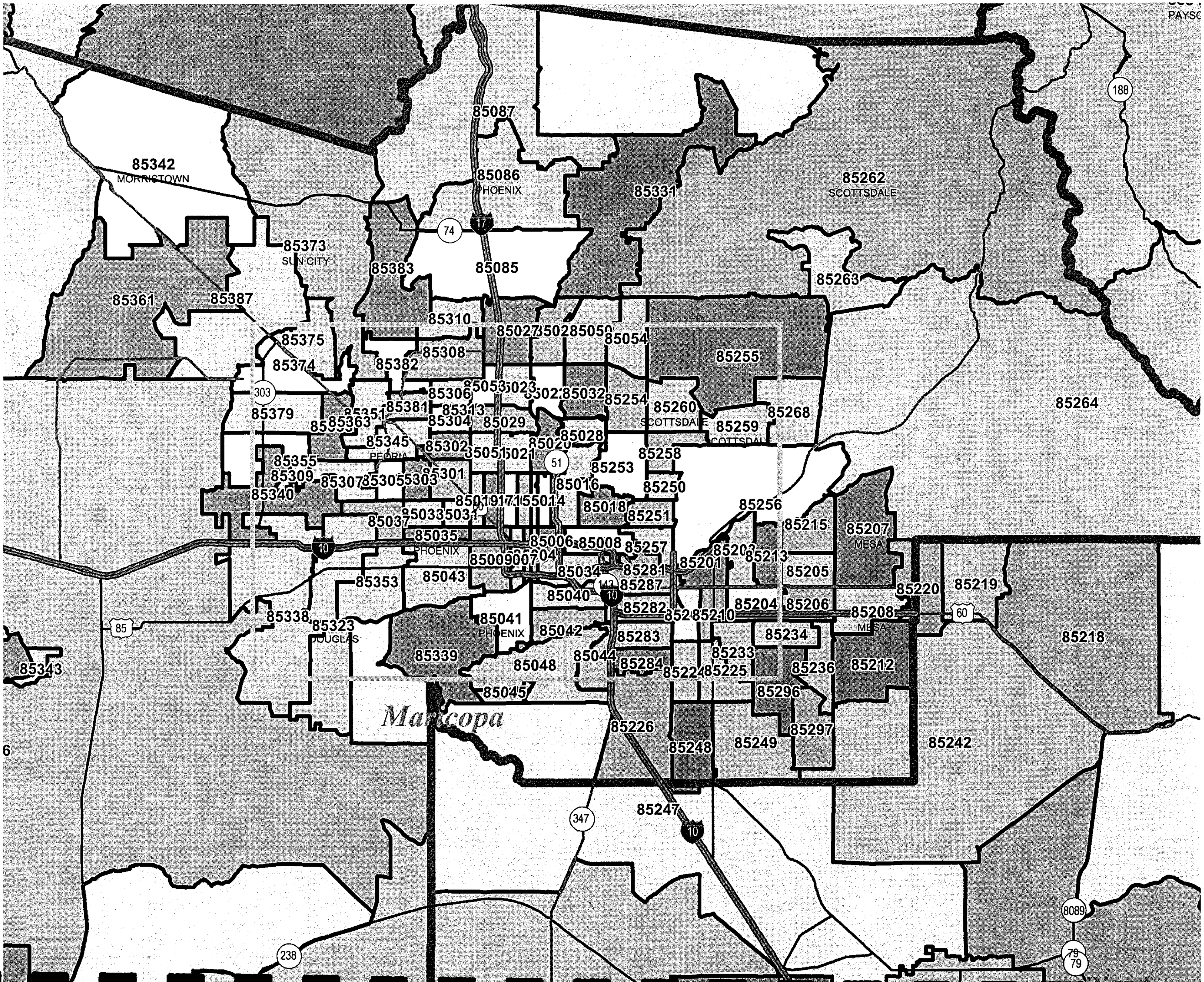
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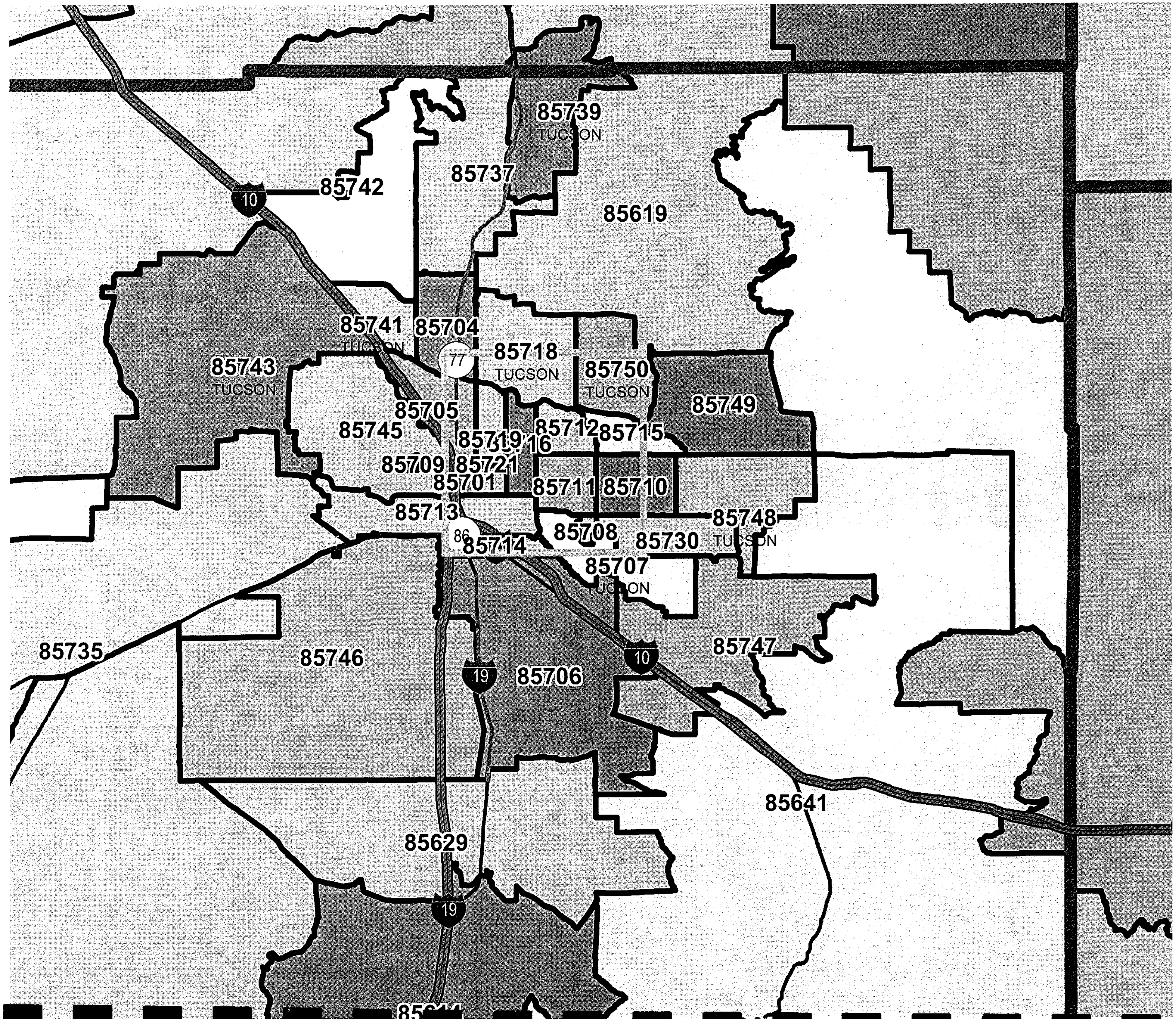
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# FIMBRES

**BEFORE THE ARIZONA CORPORATION COMMISSION**

MARC SPITZER
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

| | | |
|---|---|---|
| IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN | ) | DOCKET NO. T-01051B-03-0454 |
| IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS | ) | DOCKET NO. T-00000D-00-0672 |

DIRECT

TESTIMONY

OF

ARMANDO FIMBRES

PUBLIC UTILITIES ANALYST IV

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

NOVEMBER 18, 2004

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**EXECUTIVE SUMMARY**
**QWEST CORPORATION**
**Docket Nos. T-01051B-03-0454 & T-00000D-00-0672**

My testimony addresses the competitive situation for which Qwest submitted direct testimony in its May 20, 2004 Renewed Price Regulation filing.

Some of Qwest's ILEC service areas have several forms of competition (resale, UNE-L, UNE-P & facilities bypass) but the competitive gains in the nearly 9 year window since the 96 Telecom Act was passed highlight slow progress with little to support that acceleration is imminent.

The competitive evidence with which the Commission must make decisions concerning competitive zones is not conclusive in its current form. Resale and UNE competitive options may actually be in decline. Wireline facilities bypass is an option that has been chosen by relatively few competitors. The strongest indicator of change may be in the continuing advancement of Wireless and the potential for Voice over Internet Protocol ("VoIP") services, however, the available Wireless and VoIP evidence does not support a conclusion that these services have had significant displacement of local exchange services at this time.

VoIP services have received enthusiastic support from many advocates, including the FCC, however, they appear to be at an early-adopter stage that makes their impact not relevant or even measurable for this proceeding. Surveys consistently report that Wireless *will* displace wireline local exchange service in meaningful levels. The strongest argument, however, for the consideration of Wireless competition as a displacement for local exchange service is simply - is it possible that over 2.8 million phones could have been added to the Arizona telecommunications market without having a major impact on local exchange services? While the argument in its simple form is compelling, the available information continues to show that wireless has not yet had a major impact on the displacement of main lines, the core of local exchange services. Wireless may have had its greatest impact on the displacement of additional lines and wireline local exchange minutes of use ("MOUs") but the measurable displacement of local exchange main lines by wireless remains low.

My analysis also indicates that competitive zone decisions based on historical, ILEC wire center boundaries is not consistent with the underlying point put forward by Qwest in its application – the telecommunications landscape is changing rapidly. It may be true that if competition can be easily defined and characterized within ILEC wire center boundaries, then the competitive situation is by definition neither broad nor diverse. The confirmation of competition within ILEC wire centers boundaries may actually be a confirmation of the least impactful forms of competition rather than the most impactful. Much greater confidence and reliability could be added by moving from traditional ILEC geographic boundaries to a relatively simple measure used not only in telecommunications but in all industries – zip codes.

I recommend:
(1) Continuing analysis based on service address zip codes
(2) Annual reporting of local exchange information based on service address zip codes
(3) Continuing analysis based on listings information
(4) Continuing tracking and analysis based on MOU information

## INTRODUCTION

**Q. Please state your name, occupation, and business address.**

A. My name is Armando Fimbres. I am a Public Utilities Analyst employed by the Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

**Q. Briefly describe your responsibilities as a Public Utilities Analyst IV.**

A. In my capacity as a Public Utilities Analyst, I provide information and analysis to the Staff on telecommunications tariff filings, emerging industry issues such as VoIP, and matters pertaining to major applications such as that filed by Qwest Corporation for Renewed Price Regulation on May 20, 2004.

**Q. Please describe your educational background and professional experience.**

A. I received a Bachelor of Science degree from the University of Arizona in 1972 and have taken business and management courses at Seattle University, Northwestern University and the University of Southern California. I was employed for nearly twenty-nine years in Bell System or Bell System-derived companies, such as Western Electric, Pacific Northwest Bell, U S WEST and Qwest. The last twenty years of my Bell System telecommunications experience were in operations planning, corporate planning, or strategic planning roles with a special emphasis from 1994 to 2000 on competitive and strategic analysis for the Consumer Services Marketing division of U S WEST and similarly from 2000 to 2001 for Qwest. I have been with the Arizona Corporation Commission Utilities Division since April 2004.

**Q. What is the scope of your testimony in this case?**

A. I will address the competitive situation for which Qwest submitted direct testimony in its May 20, 2004 Renewed Price Regulation filing. My testimony will be directed to the competitive situation on which Qwest is basing its application for Competitive Zones, and other changes, within its Renewed Price Regulation application and will reflect analysis of information requested from Qwest, Competitive Local Exchange Carriers ("CLECs"), Wireless services providers and Voice over Internet Protocol ("VoIP") providers.

**BACKGROUND**

**Q. What is the purpose of your testimony?**

A. My testimony addresses several aspects of analysis necessary to make a determination regarding the competitive situation presented by Qwest Corporation in its May 20, 2004 application for Renewed Price Regulation. The purpose of my testimony is to add appropriate context to the competitive situation and thereby facilitate the communication of Staff's position regarding the regulatory changes Qwest seeks in its application. Specifically, my testimony will address the following topics: General Competitive Situation, CLEC Competition, Wireless Competition, VoIP Competition and information that has bearing on the classification of Competitive Zones.

**Q. Explain the primary information sources[1] used in your analysis?**

A. I requested and used information from a wide set of industry participants - Qwest, CLECs, Incumbent Local Exchange Carriers ("ILECs"), Wireless service providers and VoIP providers. I also analyzed information that was provided by Qwest in response to Residential Utility Consumer Office ("RUCO") data requests. Two information elements that I requested from Qwest are the basis for many of my observations above the wire

[1] Highly Confidential information in this document is denoted by light background shading with black letters. Confidential information in this document is denoted by a dark background with white lettering.

center level – Listings Information and Local Exchange Routing Guide ("LERG") information. The Listings information is useful for analysis because it contains records for all Residence and Business main accounts without regard to listing options, such as privacy or premium listings, thereby allowing analysis based on essentially 100 percent of Residence and Business local exchange main accounts in Arizona. The Listings Information is contributed by all wireline providers and, in some cases, wireless providers of local exchange services for end-user customers and is refreshed often to serve end-user needs and therefore is highly accurate. The Listings Information is particularly useful in understanding the breadth of competition in contrast to access lines or revenues that are subject to decisions made at the main account, or main listing, as contained in the Listings Information. Said another way, ownership of the main account is critical for the competitive gain of additional lines and revenues beyond basic service. Competitive gains in additional lines and revenues are really downstream from competitive gains in main accounts or main listings and in that sense are lagging indicators of the downstream competitive end-state while main accounts are leading indicators.

The LERG information is a database that contains telecommunications information essential for interconnection and is managed by Telcordia. The LERG is also updated regularly and is highly accurate because of its interconnection importance. From the LERG information it is possible to determine WHO has switches, WHAT type of switches are installed, WHERE switches are located, WHEN switches are scheduled to become active, WHICH NPA-NXXs are assigned to specific switches and many related factors, such as number pooling. Even more insights can be gained by merging the Listings and LERG information. By doing so, for example, it is possible to distinguish between the listings owner (the company responsible for end-user service) and the switch owner (the company providing the end office to which the number was originally assigned). I will make reference to the Listings and LERG information in many areas throughout my testimony.

## GENERAL COMPETITIVE SITUATION

**Q. What is the general competitive situation pertaining to Qwest's application?**

A. The length, breadth and future of the competition claimed by Qwest requires additional context to properly evaluate the proposal for competitive zones contained in Qwest's application. For example, there is general acceptance that Wireless competition for local exchange services may be accelerating as Wireless becomes a more suitable substitute for local exchange service. Also, the rules and technology required to make VoIP service a suitable alternative for local exchange service are being resolved. While there is evidence to support some of the competitive assertions in Qwest's direct testimony, the evidence must be given careful scrutiny in light of recent developments in the industry.

Although wireless services are used by some customers as substitutes for local exchange services, whether customer acceptance is broad enough geographically and has enough market diversity to rationally place wireless services on a competitive par with local exchange services remains in doubt. A similar situation exists with VoIP services. While VoIP technology appears to be a suitable alternative for local exchange services and many forecasters, including the FCC, believe customer acceptance will be high, this alternative is not currently developed and accepted on a widespread basis such that it is now an alternative to traditional wireline service.

The situation pertaining to CLECs is subject to some uncertainty as well. My analysis shows that CLECs remain the principal, demonstrable competitors for the local exchange services offered by Qwest. In my testimony, I will place the level of competition faced by

Qwest in the context required for the Commission to more thoroughly assess Qwest's competitive zone proposal.

**Q. What is CLEC competition?**

A. CLECs provide alternatives to ILEC services by (1) reselling Qwest's services, (2) using unbundled network elements ("UNEs") supplied by Qwest, (3) deploying CLEC-owned facilities-based[2] wireline systems or (4) by mixing the options. Qwest's testimony specifically addresses the services of ten CLECs – (1) Cox, (2) AT&T, (3) Eschelon, (4) McLeodUSA, (5) MCI, (6) SBC, (7) Sprint, (8) XO, (9) Xspedius, (10) Z Tel – and points to 64 CLECs listed on the Arizona Corporation Commission's (ACC) website[3]. My analysis of the Listings information confirms the presence of these 10 competitors in some markets served by Qwest. My testimony, however, will clarify that while many CLECs are listed with the ACC, the number of substantial or active competitors is much smaller than the 64 referenced by Qwest.

**Q. What is Wireless competition?**

A. Wireless providers use communications systems with technology dependent on spectrum assignments from the FCC and were originally focused on serving the mobility needs of end-users. The systems of wireless providers operate differently than wireline providers and the instruments used by customers are visually and functionally different than those used by customers with wireline service. But, aside from mobility, the features, and service functionality delivered reasonably equate to those of local exchange services and can be used by customers as substitutes for wireline local exchange services. The three main deficiencies of wireless service from a consumer perspective are (1) the lack of E-911 comparable to local exchange service, (2) an undedicated loop that makes home

[2] Facilities-based in this testimony does not include UNE-P which is functionally similar to resale.
[3] As of November 5, 2004, 69 CLECs were listed at http://www.cc.state.az.us/utility/utility_list/CLEC_list.pdf

security service less feasible and (3) quality of service problems in some areas. While wireless networks and wireline networks are designed to interconnect, the end-user instruments are not transportable between networks. Qwest's testimony specifically references seven wireless providers - ALLTEL, AT&T Wireless, Verizon Wireless, Cricket Communications, Nextel Communications, Sprint and T-Mobile. My testimony will address the general competitive situation in which these providers participate.

**Q. What is VoIP competition?**

A. Voice over Internet Protocol, or VoIP as it is commonly known, is a broadband-based technology that has been gaining support for several years and may be on the verge of gathering measurable momentum. In its simplest form, VoIP looks to end-users like wireline local exchange service since the end-user instruments can be the same. With its unique technology, however, VoIP is able to utilize any broadband network based on wireline or wireless technology. VoIP has its greatest impact on the Public Switched Telephone Network ("PSTN") when Digital Subscriber Loop ("DSL") technology is used by ILECs and CLECs to originate and terminate traffic. In contrast, however, it is possible for a broadband network, such as a cable video network with cable modems, to parallel the PSTN using VoIP or interconnect with the PSTN in the same manner as wireless networks parallel or interconnect with the PSTN. Immediate cost benefits with VoIP, however, exist only for those end-users who *already have broadband* and add VoIP service incrementally. Without viewing VoIP service as incremental to broadband service, wireline local exchange service is clearly less costly. Qwest's testimony specifically references four VoIP providers – AT&T, Five Star Telecom, Vonage and Packet8.

## CLEC COMPETITION

**Q. What is the state of CLEC competition in Arizona?**

A. My analysis indicates that 42[4] CLECs have one or more residence or business main listings. (see Exhibit AFF-1) CLECs hold 18.7 percent of Business Main Listings and 21.9 percent of Residence Main Listings statewide. The range of participation, however, appears to be quite broad. For example, of the 42 CLECs mentioned above, the top 10 CLECs hold business main listings that range from **[redacted]** to **[redacted]** or 92.4 percent of all CLEC business main listings. The other 32 CLECs hold only 7.6 percent of all CLEC business main listings.

Exhibit AFF-2
Listing Information
- June 18, 2004 -

| | Business | Residence |
|---|---|---|
| Total State Main listings | **[redacted]** | **[redacted]** |
| # of CLECS | **[redacted]** | **[redacted]** |
| CLEC Listings | **[redacted]** | **[redacted]** |
| % CLEC Listings of Total State | **[redacted]** | **[redacted]** |
| Listings of Top 10 CLECs | **[redacted]** | **[redacted]** |
| % Top 10 CLEC Listings of Total CLECs | **[redacted]** | **[redacted]** |

The top 10 CLECs hold residence main listings that range from **[redacted]** to **[redacted]** or 99.4 percent of all CLEC residence main listings. The other 32 CLECs hold only 0.6 percent of all CLEC residence main listings. Only 5 CLECs appear in both top 10 lists – AT&T, Arizona DialTone, Cox, MCI, and McLeodUSA. Two of the ten CLECs referenced in Qwest's testimony as major competitors – SBC & Xspedius – do not appear in either top ten list. SBC's totals suggest it is not a major competitor in Arizona. Xspedius's presence is apparent but below the top ten list for business main listings.

[4] Based on listings information from Qwest dated 06/18/04 in response to STF 3.20

**Q. What does your analysis suggest about facilities-based CLEC competition?**

A. My LERG[5] analysis discloses that 21 CLECs have 45 digital switches ("DSs"), those typically used by wireline providers for end-offices, with 279 assigned NPA-NXXs statewide. While switches can have considerable range in capacity, the 279 NPA-NXXs point to a maximum capacity of 2,790,000 numbers and corresponding switched access lines. The maximum capacity is reduced somewhat by number assignments made at the Thousands Group level to non-CLECs. Thousands Group level assignments are commonly known as number pooling. My analysis shows that of 1,824 assigned NPA-NXXs in Arizona, only 84 have thousand group assignments involving more than one provider. However, 87 NPA-NXXs assigned to CLEC DSs cannot be found in the Listings Information and, therefore, may be used for something other than end-user purposes or unused altogether.

Exhibit AFF-3

| | Arizona Digital Switch Situation |
|---|---|
| # of CLEC DSs | [redacted] |
| # of CLECs with DSs | [redacted] |
| # of Qwest DSs | [redacted] |

| | NPA-NXXs In Arizona |
|---|---|
| State-Wide | [redacted] |
| Assigned to CLEC DSs | [redacted] |

28 CLEC DSs can be seen serving at least one business main listing; 15 DSs have at least 100 business main listings. 19 CLEC DSs can be seen serving at least one residence main

[5] LERG data provided by Qwest 06/21/04 in response to STF 3.21

listing; 13 DSs have at least 100 residence main listings. 12 CLEC DSs have no listings at all and perhaps are unused for end-office purposes.

By joining the LERG information with the Listings Information, I found that 91 percent of CLEC business main listings and 76 percent of CLEC residence main listings are assigned to Qwest NPA-NXXs. This suggests that CLECs are competing for established customers, through the use of number portability in a much higher proportion than for new customers who would establish service with new numbers assigned directly to facility-based CLECs. This is further substantiated by the per cent of Cox business and residence main listings that are attributable to Qwest NPANXXs – [redacted] respectively.

**Q. What does your analysis suggest about Resale or UNE-P competition in Arizona?**

A. Staff offers the following observations about recent events and future trends:

1) - UNE-P competition has grown over the last three years, taking over as the preferred means of providing local service by CLECs without their own local networks. Key uncertainties, however, are now linked to recent USTA II rulings and expected FCC unbundling rules. Continued use of this option by CLECs is highly uncertain and, therefore, problematic as evidence of continuing CLEC competition. As Qwest CEO Richard Notebaert stated in early September[6], "...Qwest had seen a roughly 50 percent drop last month in new residential lines leased to competitors over the previous month..." While this statement was not specific to any state, its general significance must apply to Arizona, second in market size only to Washington State within Qwest's ILEC region.

2) - Announcements by two key competitors identified by Qwest – AT&T and MCI – are evidence that UNE-P competition should decline. In June, 2004, AT&T announced[7] it

[6] Reuters.com, September 9, 2004, "Baby Bells See Rivals Taking Fewer Phones"

[7] Associated Press, 6/23/04, "AT&T Stops Taking Residential Customers in 7 States"; Washington Post, 6/24/04, "AT&T pulling back in state"; Reuters, 6/29/04, "AT&T plans more cuts in consumer business"

would discontinue marketing to residential customers in several states due to UNE-P uncertainties and followed with a more comprehensive announcement in July[8]. MCI followed with a similar announcement in early August[9]. The existing local exchange residential base of both companies should decline through customer churn or migration strategies.

3) – Resale, UNE-L and UNE-P are CLEC options that have broadened the competitive base for residence and business. Without CLEC use of these options, competition will depend on those with complete networks, such as Cox, or emerging technology alternatives, such as VoIP. As discussed earlier, the necessary switching capacity appears to be available but few CLECs have essential end-user loops and distribution networks. At least **[redacted]** of all CLEC residence main listings are held by Cox Communications, a facilities-based CLEC. This contrasts to **[redacted]** of all business main listings being held by the top CLEC known to be using facilities bypass service, but in concert with resale and UNE options. To equal the **[redacted]** residence figure for business requires inclusion of the top 5 CLECs, all of whom appear to be mixing resale, UNE-L and UNE-P options with facilities bypass. The recent FCC decision[10] to not require RBOCs to unbundle fiber optic broadband local networks will not help UNE based competition.

**Q. Where are CLECS providing competitive local exchange service in Arizona?**

A. Information provided by Qwest in response to RUCO's data requests[11] allows for additional resale and UNE analysis. At least one form of competition exists in **[redacted]** of the 136 wire centers listed on Qwest's SGAT[12] website information. (see Exhibit AFF-4) UNE-L competition exists in **[redacted]** wire centers, **[redacted]** of which are in UNE

[8] AT&T news release, 7/22/04
[9] The Washington Times, August 6, 2004, "MCI set to downsize residential service"
[10] FCC news release, October 14, 2004, "FCC Removes More Roadblocks To Broadband Deployment In Residential Neighborhoods"
[11] RUCO DR#2
[12] http://www.qwest.com/wholesale/clecs/sgatswireline.html

Rate Zone 1, **[redacted]** in Zone 2 *but only* **[redacted]** in Zone 3. (see Exhibit AFF-5) UNE-P competition exists in **[redacted]** wire centers, **[redacted]** of which are in Zone 1, **[redacted]** in Zone 2 and **[redacted]** in Zone 3. Residential resale competition exists in **[redacted]** wire centers, **[redacted]** of which are in Zone 1, **[redacted]** in Zone 2 and **[redacted]** in Zone 3. Business resale competition exists in **[redacted]** wire centers, **[redacted]** of which are in Zone 1, **[redacted]** in Zone 2 and **[redacted]** in Zone 3. Facilities bypass competition is *estimated* by Qwest in **[redacted]** wire centers, **[redacted]** of which are in Zone 1, **[redacted]** in Zone 2 and **[redacted]** in Zone 3.

Exhibit AFF-4

| | Qwest Wire Centers |
|---|---|
| # StateWide | **[redacted]** |
| # with Competitive Presence | **[redacted]** |
| # with UNE-L | **[redacted]** |
| # with UNE-P | **[redacted]** |
| # with Res Resale | **[redacted]** |
| # with Bus Resale | **[redacted]** |
| # with Facilities Bypass | **[redacted]** |

While some wire centers have all four forms of competition (resale, UNE-L, UNE-P & facilities bypass), the competitive gains in the nearly 9 year window since the 96 Telecom Act was passed highlight slow progress with little to support that acceleration is imminent. Qwest is requesting competitive flexibility in the form of Competitive Zones in 37 of 39 UNE Zone 1 wire centers, 17 of 33 Zone 2 wire centers and 28 of 64 Zone 3 wire centers so Staff has conducted additional analysis to determine the appropriateness of Qwest's request.

Exhibit AFF-5

| | UNE | | | |
|---|---|---|---|---|
| Type of Competition | Zone-1 | Zone-2 | Zone-3 | Total |
| UNE-L | [redacted] | [redacted] | [redacted] | [redacted] |
| UNE-P | [redacted] | [redacted] | [redacted] | [redacted] |
| Residence Resale | [redacted] | [redacted] | [redacted] | [redacted] |
| Business Resale | [redacted] | [redacted] | [redacted] | [redacted] |
| Facilities Bypass | [redacted] | [redacted] | [redacted] | [redacted] |

Staff's comprehensive discussion of Qwest's request for competitive zone classification is addressed in the testimony of Staff Witness Matthew Rowell.

**Q. What services are CLECs providing in Arizona?**

A. Qwest submitted tariff and service information for ten CLECs - Cox, AT&T, Eschelon, McLeodUSA, MCI, SBC, Sprint, XO, Xspedius, and Z Tel. While the tariffs illustrate opportunities for broad residence and business local exchange service competition, the available evidence indicates that most of the 10 CLECs identified by Qwest are focused on providing business services. Only Cox appears to have a major emphasis on residence service. Only Cox appears to be committed to wide-spread, residential, facilities-based competition, the only form of local exchange service provisioning that allows for full local exchange service differentiation. Those using Resale or UNE-P are largely limited to differentiating with marketing approaches and service bundles enhanced by wireless, broadband or long distance elements. The levels of business and residence customer listings may also be indicative of very focused or selective marketing. A concept that is also generally obvious across the industry regards packaging and bundling, as illustrated by Qwest's own application. In an industry where long distance revenues have dropped considerably in recent years and access line growth[13] is, at best, flat, many companies are focusing on increased revenues per account through packages that provide more services.

[13] FCC, May 6, 2004, Trends in Telephone Service, Table 7.4

**Q. Did you look at the CLECs specifically referenced by Qwest in its testimony?**

A. Using Listings information joined with LERG information, I was able to do a comparative evaluation of the CLECs' digital switch capability. (See Exhibit AFF-6) It is no surprise that Qwest has far more capacity than any of the CLECs but the amount of local switching capacity available to Cox, AT&T, Eschelon, McLeodUSA, MCI, SBC, Sprint, XO, and Xspedius is, nonetheless, impressive. I found no evidence, however, that Z Tel has any switching capacity. Based on the information to which I have access, I believe that Z Tel is not providing switched access, local exchange services with its own facilities. Among this set of CLECs, I found 15 digital switches in Phoenix and 3 in Tucson. Additionally, I found 67 NPA-NXXs assigned to the Phoenix area (480, 602, 623) and 9 to the Tucson area (520).

The relative end-user presence of Cox, AT&T, Eschelon, McLeodUSA, MCI, SBC, Sprint, XO, Xspedius and Z Tel can be further defined by indexing the listings information against those of Qwest to protect the privacy of highly confidential information. An index is a means of standardizing the relative proportions of information thereby facilitating comparative analysis.

Exhibit AFF-7

| | Phoenix Area Main Listings | | | Tucson Area Main Listings | |
|---|---|---|---|---|---|
| | Bus | Res | | Bus | Res |
| Qwest | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Cox | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |

| | | | | | |
|---|---|---|---|---|---|
| AT&T | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| MCI | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Eschelon | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| McLeodUSA | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| SBC | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Sprint | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| XO | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Xspedius | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Z Tel | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |

Exhibit AFF-7 was developed by setting all Qwest listings totals to a value of 100, allowing relative CLEC values to be derived for the purpose of comparison. A 0 value does not necessarily mean 0 listings but rather that the number of listings is so small relative to those of Qwest that they equate to 0 in the context presented. This analysis is not meant to be conclusive. It simply provides one more means of evaluating the level of local exchange competition.

Only Cox, AT&T, and MCI have residence main listing indices above **[redacted]**. This is especially worrisome because AT&T and MCI have indicated they will no longer pursue residence CLEC customers. Only Cox's Phoenix residence main listings index is greater than **[redacted]**. AT&T's Phoenix business main listings index is next highest at **[redacted]** but all other indices are well below **[redacted]**. While it is startling to see so many zeros in the residence columns, consider that *all* positive figures except those for Cox could conceivably move toward zero if resale or UNE options diminish in use by major CLECs. In this simple comparative form, competitive levels are not impressive.

**Q. What about other CLECs with switches?**

A. Based on my analysis, there are another **[redacted]** DSs available to 11 CLECs not specifically noted by Qwest in the Phoenix area – Allegiance, Electric Lightwave, Global Crossing, Great West, Level 3, Mountain Tel, North Country, Pac-West, TCG (acquired by AT&T), Time Warner and Winstar. While these switches are present in the LERG data, if, and how, these switches are being used is very much in question. Some switches have no listings currently and, therefore, may not be in use or may be used for something other than end-user, switched-access, local exchange services. Winstar[14], for example, does not appear to be providing CLEC service in AZ at this time. A similar situation can be seen in Tucson where [redacted] DSs are held by Brooks (acquired by MCI), Level 3, TCG (acquired by AT&T) and Time Warner. While some allowance must be made for the timing of the data, more switching capacity would appear to be available, but underutilized, than suggested by the CLECs specifically identified by Qwest in its application.

Exhibit AFF-8

Total Other Digital Switches in AZ

| | Phoenix | Tucson |
|---|---|---|
| [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] |

**Q. Are there other means to measure the level of CLEC competition in Arizona?**

[14] Winstar has an application for service withdrawal before the Commission, T-03023A-04-0317

A. The level of CLEC competition can be measured in more than one manner, for example through an analysis of lines, revenues or listings information as discussed earlier. Given the visibility, accuracy, breadth and real-time operational nature of the Listings Information, as discussed earlier, I chose to use the Listings Information to derive Herfindahl-Hirschman Index ("HHI") estimates that help gauge the level of competitive presence through measuring market concentration. Market concentration is commonly understood to be a function of the number of firms in a market and their respective market shares.

The HHI[15] measure is a commonly accepted measure of market concentration used most notably by the U.S. Department of Justice in its evaluation of merger applications. It is calculated by squaring the market share of each firm competing in a market, and then summing the resulting numbers. The HHI can range from a minimum of nearly 0 to a maximum of 10,000. The DOJ regards markets with an HHI below 1,000 to be unconcentrated; markets with an HHI between 1,000 and 1,800 to be moderately concentrated; and markets with an HHI above 1,800 to be highly concentrated.

Using the Listings Information, I estimated a statewide HHI of 5,336 for Residence and 5,168 for Business. These HHI figures take into consideration the end-user presence of all ILECs and CLECs in Arizona. Limiting the estimates to just Qwest and all CLECs in Arizona changes the HHI for Business to 6,333 and for Residence to 6,124. Further limiting the estimates to Phoenix metro[16] and Tucson metro[17] changes the Phoenix HHI business and residence figures to 5,916 and 5,529, respectively, and the Tucson HHI

[15] http://www.usdoj.gov/atr/public/guidelines/hmg.htm
[16] NPAs 480, 602, & 623
[17] NPA 520

business and residence figures to 7,168 and 7,292, respectively. (see Exhibit AFF-9) These figures suggest that the local exchange market is highly concentrated.

Some may believe that the HHI figures would be much lower if based on access lines. It is worth pointing out, however, that for any HHI figure to drop below the DOJ upper range of 1,800 used to define a moderately concentrated market, Qwest's market share, however measured, would have to drop below 43 percent. Even in the more generous state wide figure based on listings noted above, Qwest's business and residence main listing shares are above 70 percent. Therefore, I believe it reasonable to use these HHI estimates as a fair measure of the current local exchange service market concentration in Arizona, Phoenix metro and Tucson metro.

**Q. Did you look at the level of competition in any other way?**

A. Yes. I made use of resale, UNE and bypass estimated information provided by Qwest in response to RUCO's data requests, as well as the exhibit information provided by Qwest in exhibit DLT-17[18] of its application. By sorting and aligning the information into Phoenix and Tucson wire center areas, I was able to determine HHI factors based on line information to compare with those based on listings information as described earlier. Using the line loss information, I calculated combined HHIs of 5,483 for Phoenix and 5,867 for Tucson. Separate HHIs for Business and Residence were not possible to calculate since the facilities bypass information, UNE-P and UNE-L estimated by Qwest is not easily separated into business and residence. I was able, however, to combine the HHIs generated via the listings information for simple comparison with the HHIs generated using Qwest's line information. Combined HHIs for Phoenix metro and Tucson metro based on listings information are 5,532 and 7,273 respectively.

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[18] Revised per Qwest's response to STF 3.15

The most notable difference in the results of HHI based on lines, as provided by Qwest, and those based on listings concerns the Tucson area. My analysis reveals major differences between the number of CLECs believed by Qwest, as measured by its line information, to be involved in local exchange competition and those that can be seen active in the listings information. Two differences are worth noting in the following exhibit.

Exhibit AFF-10

| | Phoenix Metro | | Tucson Metro | |
|---|---|---|---|---|
| | Lines | Listings | Lines | Listings |
| HHI | [redacted] | [redacted] | [redacted] | [redacted] |
| CLECs | [redacted] | [redacted] | [redacted] | [redacted] |
| >=0.1% Share | [redacted] | [redacted] | [redacted] | [redacted] |
| Qwest Share | [redacted] | [redacted] | [redacted] | [redacted] |
| Mkt Total | [redacted] | [redacted] | [redacted] | [redacted] |
| Qwest # | [redacted] | [redacted] | [redacted] | [redacted] |
| CLEC # | [redacted] | [redacted] | [redacted] | [redacted] |

(1) The line information provided by Qwest points to 40 business and residence CLECs in Tucson while the listings information points to only 33 CLECS. (2) The CLEC facilities-based line estimate provided by Qwest is driven by Local Interconnection Service ("LIS") trunk information and a multiplier of 2.75[19]. While this methodology may be appropriate for some confirmed facilities-based providers, several of the key LIS trunk users in Tucson cannot be found in the listings information at all. Most significant are Level 3, KMC Telecom and Pac-West. KMC Telecom did not even complete its Access Services tariff with the ACC until August, 2004 nor does it have an identified end-office. Level 3

[19] Qwest explains in response to RUCO 02-038S1 "…this is a conservative assumption…a single trunk can support up to approximately 10 facilities-based lines (source: UNE Fact Report, Section III, P. 14, May 26, 1999)"

does not provide any local exchange services directly to end-users[20]. While CLECs, such as these, may be providing interconnection services, they are not likely providing switched access services directly to end-users. They should, therefore, not be included in an analysis intended to reflect the state of switched access, local exchange competition. It should also be noted that the estimate for Cox derived by Qwest's LIS trunk translation to lines understates Cox's total lines. There are, therefore, issues with some estimates being too low and some being too high with this methodology.

**Q. What are the general economic condition and business strategies of the CLEC industry?**

A. Commenting on the economic condition of the CLECs in Arizona, requires more resources and time than reasonably available, so I will limit my comments[21] in this area to the 10 CLECs referenced by Qwest in its testimony - Cox, AT&T, Eschelon, McLeodUSA, MCI, SBC, Sprint, XO, Xspedius, Z Tel. Unless otherwise noted, my comments regard publicly available information for the parent company rather than just the specific CLEC entity.

Cox and SBC would have to be considered at the top in terms of financial health. Both are large and diverse companies whose core revenues are derived from areas other than Arizona local exchange service.

**1. Cox**

Cox Communications is an indirect 63.4 percent majority-owned subsidiary of Cox Enterprises with total 2003 revenues exceeding $5.7 billion, of which about 8 percent have been attributed to telephony. Cox's core revenues arise from the 6.3 million video

[20] per Level 3 response to STF 2.1
[21] Based on information obtained from Yahoo, Hoovers and company websites.

customers it serves nationally. Cox offers video and high-speed Internet access in almost all of its markets, telephone service in a number of markets and advanced services in select markets. Cox launched its Phoenix cable phone service in 1998[22] and its Tucson cable phone service in 2003[23]. Cox appears committed to local exchange service and has also announced plans for VoIP service. It remains to be seen how Cox's operations will be impacted by Cox Enterprises' plans to acquire full ownership and take Cox Communications private.

**2. SBC**

SBC has evolved from one of the seven RBOCs divested from AT&T in 1984 into a holding company anchored by the merger of Southwestern Bell, Pacific Telesis, and Ameritech. SBC has 55 million access lines in 13 states but relatively few in Arizona. Its wireless operations were joined with those of BellSouth to form Cingular Wireless and now rank #2 nationally behind Verizon Wireless with 24 million subscribers in 38 states. SBC offers its services and products to businesses and consumers, as well as other providers of telecommunications services. Although SBC's stock has dropped along with the overall industry, there is little concern about SBC's financial health. SBC has the experience, market strength and resources to execute many strategies for many service offerings in many markets. It appears, however, that SBC is "maintaining a small number of mass-market customers but is not seeking to acquire any new customers[24]" in Arizona.

**3. AT&T, MCI and Sprint**

[22] X-changemag.com, 08/1999, Phoenix Area Offers Enormous Growth Potential
[23] Cox news release, June 23, 2003, Cox Communications Launches Cox Digital Telephone Service Throughout Tucson and Green Valley, Arizona
[24] Direct testimony of Matthew Rowell, T-00000A-03-0369, page 21, line 19, response to Staff data request 3-1 and 3-2.

Much has been written about the financial and organization changes that AT&T, MCI and Sprint have undergone in recent years. The three have been the backbone of US long distance services since the mid-1980s but have struggled as long distance industry revenues have declined with the advance of alternatives such as email and wireless. The brand recognition and long distance market strength of AT&T, MCI and Sprint remain formidable, however, their economic condition does not appear to match that of Cox or SBC and their commitment to local exchange service appears to have shifted to VoIP. New investments in Arizona's traditional local exchange services seem unlikely.

**4. McLeodUSA**

McLeodUSA's telecommunications services, in 25 Midwest, Southwest, Northwest and Rocky Mountain states, continue to recover from bankruptcy and reorganization in 2002. EOY 2003 revenues were 68 percent of EOY 2001. McLeodUSA offers local and long distance service, Internet access and other data services, primarily to small and midsized businesses. Mid-year 2004 revenues were $385M. McLeodUSA is sustained in part by a telecommunications history that began in the Midwest well before the 96 Telecom Act but declining revenues for the third consecutive year and a stock price that has dropped below 50 cents may pose investment limits for local exchange service.

**5. XO**

XO sought Chapter 11 bankruptcy protection in 2002, emerged in 2003 and has since completed the acquisition of Allegiance Telecom. XO began as NEXTLINK, a broadband communications provider, in 1994 and combined with Concentrix to provide a broader set of communications services in September 2000. XO offers a variety of access options including fiber direct to buildings, DSL (digital subscriber line), and fixed-wireless technologies and is primarily targeting small and midsized businesses. Although XO's stock had dropped in 2004, as have many others, its mid-September price was $3.35.

**6. Eschelon**

Eschelon originated as Advanced Telecommunications, Inc. in 1996 and now provides telecommunications services in 12 markets in seven states, with only Nevada outside of Qwest's ILEC area. Eschelon provides local and long-distance, Internet access, leased lines, and data services, primarily to small and midsized businesses. In relative terms, Eschelon is a fairly new provider with $141M in 2003 revenues.

**7. Xspedius**

Xspedius is a privately held company with little known publicly about its financial condition. Some recent changes, however, are typical of general changes seen in the telecommunications industry. With capital infusion from Thermos Companies, Xspedius acquired the assets of bankrupt e.Spire Communications and its subsidiary, ACSI Network, in mid-2002. The e.Spire assets and operations acquired had an original invested capital basis of $1.6 billion and generated approximately $200 million of revenue in 2002 and $250 million of revenue in 2003. Xspedius offers local access, long-distance, dedicated Internet access, and other data services to business clients and wholesale customers.

**8. Z Tel**

Z Tel Communications, a.k.a., Z-Tel Technologies Inc, is a publicly traded company founded with the passing of the 96 Telecom act to compete using the UNE-P option. The Company provides telecommunications services to consumers, business and other communications companies. Z Tel's stock traded above $40 in early 2000 but in mid-September 2004 traded at $0.45, about the time when work force reductions were announced. If Z Tel is fully committed to UNE-P services, likely changes in FCC rules within the next year would seem to be a major barrier.

**Q. Please summarize your conclusions about the state of CLEC Competition in Arizona?**

A. (1) While there are as many as 69 CLECs listed with the ACC, only 42[25] CLECs can be found in the Listings Information.

(2) 21 CLECs have 45 digital switches designated as end-offices with a maximum capacity of 2,790,000 phone numbers. Whether these switches are being used primarily to provide service to end-users is unclear.

(3) Continued use of the UNE-P competitive option is highly uncertain. Some of Qwest's largest competitors in the residence market have recently announced plans to not actively market to new customers based upon the uncertainties surrounding UNE-P.

(4) Although [redacted] of 136 Qwest wire centers have some form of competitive presence, facilities-based competition can only be seen in [redacted] wire centers and only [redacted] of 64 Zone 3 wire centers have facilities-based competition.

(5) Cable providers are in the best economic and industry position to deliver alternative local exchange services. Cox is the strongest facilities-based CLEC and the only CLEC with a broad network available for residence service.

(6) HHIs estimates, whether based on Listings information analysis or line loss, measure competition well above the 1,800 threshold the DOJ uses to gauge highly concentrated markets. Using Listings information produced statewide HHIs of 5,336 for Residence and 5,168 for Business. Using line loss produced combined HHIs of 5,483 for Phoenix and 5,867 for Tucson.

[25] See Exhibit AFF-1

(7) Qwest's statewide business and residence main listing shares are above 70%.

(8) Of the 10 CLECs noted by Qwest as primary competitors, most are actively marketing service to only business customers.

(9) The competitive gains in the nearly 9 year window since the 96 Telecom Act was passed highlight slow progress with little to support that acceleration is imminent.

## WIRELESS COMPETITION

**Q. What is the state of Wireless competition in Arizona?**

A. Much less information is available regarding wireless competition than CLEC competition. Thus, a full comparative evaluation is not possible. Nonetheless, enough information points are available to allow for a reasonable understanding of the current state of wireless competition and the direction in which wireless appears to be headed.

Table 13 of the FCC's June 18, 2004 report on Local Competition provides an EOY03 estimate of 2,843,061 wireless subscribers statewide in Arizona. This compares with information from the same report estimating total statewide ILEC and CLEC wireline subscribers at 3,249,408. The AZ ratio of wireless to wireline subscribers (87.5 percent) is above the nationwide average of 86.6 percent; however, AZ ranks only 20th with Louisiana highest at 104 percent. By any measure, the number of AZ wireless subscribers is impressive and especially relevant when weighed against the FCC wireline subscribers estimate separated into ILEC and CLEC, 2,541,931 and 707,477, respectively[26]. Unless the 2,843,061 wireless subscribers in AZ are *only* viewed as telecommunications market expansion opportunities, some allowance must be given to wireless as a competitive alternative to ILEC services and pertinent to the competitive situation facing Qwest.

[26] FCC's June 18, 2004 report on Local Competition

I made an effort to gauge the impact of wireless by researching and analyzing the following areas: 1) number portability trends from wireline to wireless, 2) wireless usage (MOUs) trends, 3) local exchange listing information for wireless users, and 4) industry surveys estimating wireless displacement of wireline.

**Q. Are wireless services and packages competitive with local exchange services?**

A. Wireless services are available in a wide variety of packages and bundles that commonly include long distance and custom calling features. Many wireless packages are in the range of Qwest's local exchange service that begins at $19.68[27] for residence and $36.90 for business, as stated in Qwest's testimony. For some users, however, the cost of wireless phones, as high as several hundred dollars, and monthly fees that can be $50 and above may present barriers. It is widely acknowledged, however, that the wireless industry is reaching a state where marketing programs are increasingly being designed to attract local exchange users. Some providers, perhaps most notably Cricket, are undeniably targeting mass market audiences.

> *According to a recent company survey, 43 percent of Cricket's customers substituted a traditional phone at home with the exclusive use of their cell phones for household communications. This compares to just four percent of all wireless customers who have "cut the cord," according to the Yankee Group, a firm that analyzes telecommunications trends.*[28]

"Cutting the cord" is a term that is so well-established in the wireless industry that it can be traced back at least four years[29].

**Q. What does the number portability information suggest?**

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[27] Direct testimony of David L. Teitzel, May 20, 2004, page 60, line 17, ($13.18 plus $6.50 mandatory subscriber line charge)
[28] Cricket press release, August 17, 2004, "Cricket Customers Ditch Their Landlines"
[29] BusinessWeek, November 13, 2000

A. Number portability between wireless and wireline began in Nov'03. Even in this short period, if wireless service were displacing ILEC service, significant numbers of users should be seen moving from wireline to wireless. While the information made available to me by a few wireless providers is not comprehensive for the wireless industry in Arizona, very little impact is apparent at this time. Absent more information, I would have to say that wireline local exchange users are not currently moving their service to wireless carriers in great numbers by using number portability. Local information does contrast, however, with national information (RCR Wireless News, September 7, 2004):

> *More than 300,000 customers have cut the cord since May with more than a half a million customers switching totally to wireless since local number portability became available last November, according to numbers made available by the Federal Communications Commission.*

**Q. What does the usage (MOUs) information suggest?**

A. Although Staff issued data requests to all wireless providers in Arizona, little usage information helpful to this proceeding was provided. Information from one wireless provider, though limited, does point to the type of evidence that suggests displacement of local exchange services. From EOY02 to EOY03, the percent of **[redacted]** minutes interconnecting with Qwest in the Phoenix LATA dropped by **[redacted]**. In the Tucson LATA, the drop was **[redacted]** over the same period. These declines took place at the same time that overall subscribership across both LATAs was *increasing* by **[redacted]**. While there is no direct evidence that any local exchange service lines were dropped, end-user value, as measured in minutes of use, may arguably have shifted from the Qwest's local exchange network to other forms of interconnection, such as Wireless to Wireless or Wireless to CLECs. If usage is a leading indicator of end-user value, shifts in usage will ultimately translate to shifts in lines and revenues. I have no conclusive wireless usage evidence, however, supporting wireline local exchange displacement.

**Q. What does the listings information suggest?**

A. Being listed in Directory Assistance and/or the White Pages directory is seen by many end-users as a standard feature of local exchange service. As such, it is possible that the existence of wireless displacement could result in wireless users requesting inclusion in statewide listings services. The June 18, 2004 Listings information provided by Qwest was analyzed for the presence of wireless listings. No listings owned by the key wireless providers referenced in Qwest's application - ALLTEL, AT&T Wireless, Verizon Wireless, Cricket Communications, Nextel Communications, Sprint and T-Mobile – or any wireless provider were obvious in the listings information. **[redacted]** business main and **[redacted]** residence main listings were found in Qwest's name but tied to NPA-NXXs assigned to Qwest Wireless. These could be numbers being ported to Qwest from Qwest Wireless or foreign listings by Qwest Wireless subscribers that are listed under Qwest's name. Although the level of Listings information does not allow for exactness in this analysis, one top level number can be considered. The number of wireless users that can be assumed to have displaced their wireline main service, as measured by inclusion in the Listings information, is arguably not higher than 79 business mains and 234 residence mains[30]. These figures could include, however, main numbers that are being ported from wireless providers to ILECs or CLECs. It is important to understand, however, since wireless is not truly local exchange service, the inclusion of listings information even for those replacing their wireline service is dampened by wireless provider practices that do not appear to encourage local exchange service directory listings. The figures estimated from analyzing the listings database are so low that it is possible that those using wireless service in place of wireline local exchange service simply do not place a great value on being included in listings databases.

[30] Figures include listings from NPANXXs assigned to wireless switches but shown in listings as owned by any provider. Pooled NXXs are not included.

**Q. What do industry surveys & reports suggest?**

A. A statement from an August, 2003 IDC[31] report (U.S. Wireless Displacement of Wireline Access Lines Forecast and Analysis, 2003-2007) provides one perspective on the expected displacement by wireless.

> *Wireless displacement of wireline access lines is forecast to accelerate over the next several years as a function of wireline-wireless number portability and the increasing role that wireless plays in the lives of consumers. IDC forecasts an additional 18 million access lines to be displaced by wireless through 2007, with 2.4 million of those as a result of number portability.*

The June 7, 2004 survey by National Telecommunications Cooperative Association ("NTCA") states:

> *Survey results indicate that wireless displacement of wireline services is not just a threat but also an emerging reality. In fact, wireline displacement is growing at an alarming rate among rural youth, with 20% of survey takers saying they "rarely" use the landline phone in their residence, up from just 13% last year. Those indicating they "never" use the landline phone in their homes also jumped sharply, from 6% last year to 14% this year. This trend shows the slow but steady progression of the youth market toward complete disassociation from landline phones.*

A Yankee Group report released in March 2004 (2003 TAF Survey Findings Highlight the Consumer Market's Competitive Challenges) states:

> *...wireless usage is accelerating the decline of landline minutes of use. Although the number of U.S. households that have totally cut the wireline voice cord remains small, fifty percent of wireless households report their wireless usage has replaced some, a significant amount or all of their regular telephone usage. The most dramatic impact of wireless displacement on wireline voice is in long distance, where wireless users indicate on average that they now make forty-three percent of their long-distance calls on their wireless phones.*

Forrester Research in its March 31, 2004, Cord-Cutting Goes Mainstream report stated:

> *At the end of 2003, 4% of US households that subscribe to mobile service said that they have given up their landline service, and nearly twice that many intend to do so in the next three years.*

[31] International Data Corporation

Jupiter Research states in its April 23, 2004 report:

> *With wireless customer growth in the low single digits, US carriers have all announced that they are looking to landline displacement to add customers and keep minute usage up. However, under six percent of US consumers today are actually using their wireless phone as their only phone.*

Perhaps the most aggressive information regarding the displacement of wireline services by wireless can be found in a February 2004 report from Scottsdale, Arizona research firm, In-Stat/MDR (see Exhibit AFF-11):

> *...14.4% of US consumers currently use a wireless phone as their primary phone, with the remaining 85.6% still using a landline as their primary phone. However, among those consumers still using a landline as their primary phone, 26.4% would consider replacing it with a wireless phone, demonstrating a significant potential for wireline displacement over the next five years*

In-Stat/MDR has forecasted a major shift in telephone usage[32] driven by men and women between the ages of 18 and 24 (see Exhibit AFF-11):

> *This tectonic shift in telephone service - by 2008 an estimated one-third of existing phone customers won't have land lines in their homes - threatens the customer base and future profitability of regional phone companies, especially Denver-based Qwest, which doesn't have its own wireless division*

Surveys consistently report that wireless *will* displace local exchange main lines in meaningful levels. Nationally, there is survey evidence to support 4-6 percent main line displacement. Absent more local information, however, it is not clear that meaningful levels *have* been reached at this time.

**Q. What about the impact of wireless on local exchange service additional lines?**

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[32] Denver Post, October 17, 2004, "The Young and the Wireless"

A. Most of the survey information, as noted above, tends to address the general displacement of wirelines without exact distinctions between main and additional lines. One way to estimate the impact on additional lines is to consider the range of estimates in key surveys. Using the difference between the upper range of 14 percent from In-Stat/MDR[33] and the lower range of 4 percent-6 percent that offered by Forrester Research[34], Jupiter Research[35] and Yankee Group[36] provides an estimate of 8 percent-10 percent that could be considered additional lines. Applying this range against the wireless subscriber estimate of 2,843,061 from the FCC (see Exhibit AFF-11), allows for a derived range of 227,444 to 284,306 additional line displacement. Although this is a simple estimate, it easily exceeds the estimated Qwest residence additional line figure of **[redacted]** lines[37]. This estimate adds weight to the general belief that wireless is having its greatest impact on wireline additional lines. Nationally, the FCC reports[38] that residence additional lines reached 26.2 million in 2000 and declined to 18.7 million by end of year 2002.

**Q. Did you research the FCC's position regarding wireless?**

A. Staff reviewed a number of FCC documents. These documents can be viewed in summary as supporting a position that wireless is not a full alternative for local exchange service.

For example, the FCC recognizes in paragraph 53 of its TRO order[39] that the mass market growth of wireless has been "remarkable". Nonetheless, the FCC goes on to say that only "3 to 5 percent of wireless customers use their wireless phone as their only phone." Additionally, the FCC addresses general beliefs about the impact of wireless on wireline

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[33] In-Stat/MDR, February 2004
[34] Forrester Research, March 31, 2004
[35] Jupiter Research, April 23, 2004
[36] Delwareonline.com, The News Journal, July 23, 2004, "More phone users are hanging up land lines"
[37] Derived from residence lines included in Qwest's response to STF 31.1 less residence main lines in Qwest's response to STF 3.20
[38] FCC, Trends in Telephone Service, May 6, 2004, Table 7.4
[39] FCC-03-36A1

access lines by stating "Some carriers attribute, at least in part, the recent drop in wireline switched access lines to this replacement of wireline phones by wireless phones. This replacement may particularly affect second-line growth." At paragraph 230, the FCC states "...the record demonstrates that, although promising, wireless CMRS[40] connections in general do not yet equal traditional landline local loops in their quality, their ability to handle data traffic, and their ubiquity." At paragraph 245, the FCC appears to summarize its position by stating "Neither wireless nor cable has blossomed into a full substitute for wireline telephony". An important fact can be found in footnote 702 of the FCC TRO order " AT&T points out, for example, that wireless service is engineered to provide only roughly 70% call completion rate while wireline call completion rates exceed 99%."

**Q. Is it possible to estimate an HHI with the inclusion of wireless?**

A. Combining the 14 percent displacement figure from In-Stat/MDR, a well-known market research firm, as a top-line estimate with a set of related assumptions (see Exhibit AFF-11) and the CLEC and Qwest listings information, it is possible to calculate HHI estimates that include wireless. With wireless, the business HHI changes from 6,333 to 3,825 and the residence HHI changes from 6,124 to 4,747. While much lower, HHIs that included wireless estimates demonstrate a high level of market concentration. Indeed, these figures remain well above the range (1,000 - 1,800) used by the DOJ to characterize moderately concentrated markets. For completeness, I estimated an HHI of 3,624 for total access lines by making assumptions about additional line displacement by wireless combined with the line estimates provided in response to RUCO's data request #2. These figures illustrate a dramatic impact, assuming wireless can truly be considered a competitive alternative for local exchange service.

[40] Commercial Mobile Radio Service

Although it is important to consider estimates and to test key assumptions where more exact information is not available, I still believe that the market evidence is insufficient to reasonably conclude that wireless is a competitive alternative for local exchange services in the same context as services provided by CLECs.

**Q. Please summarize your conclusions about the state of Wireless Competition in Arizona?**

A. (1) The number of wireless phones in Arizona equate to about 87.5 percent of the wireline phones, according to the FCC's June 18, 2004 report on Local Competition.

(2) Many wireless providers appear to be participating in the AZ markets served by Qwest – ALLTEL, AT&T Wireless[41], Nextel, Sprint, Verizon, T-Mobile, and, of course, Qwest Wireless[42].

(3) Wireless packages and services are becoming competitive with wireline packages.

(4) Listings analysis does not indicate a significant number of wireline customers using wireless as a substitute for local exchanges service.

(5) Number portability figures do not indicate a major shift of wireline local exchange customers to wireless.

(6) Limited MOU information does suggest a major reduction in interconnection minutes between Qwest and wireless providers.

(7) Market research firms support wireless displacement of wireline in the low range of 4 to 6 percent with one firm (In-Stat/MDR) estimating a high point of 14.4 percent using wireless as their *primary phone.*

(8) The data I reviewed indicates that wireless may have had its greatest impact on the displacement of additional lines and wireline local exchange minutes of use.

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[41] Acquisition by Cingular completed October 26, 2004

[42] The Commission recently approved Qwest Wireless' transfer of its wireless assets to Sprint. In its Application, Qwest Wireless indicated that it would continue to provide wireless service to customers, but as a reseller.

(9) The FCC recognizes the growth of wireless in mass markets but does not believe wireless is a full substitute for wireline telephony. The FCC estimates that 3 to 5 percent of wireless customers use their wireless phone as their only phone.

(10) Even using estimated wireless market share figures, HHIs calculated on a statewide level remain well above the 1,800 threshold the DOJ uses to gauge highly concentrated markets. Combining the highest estimate of wireless displacement with the listings information produces a business HHI change most favorable to Qwest from 6,333 to 3,825 and a residence HHI change from 6,214 to 4,747.

(11) Qwest does not include wireless in its competitive zone criteria but Staff believes some consideration is warranted under R14-2-1108 analysis. The degree of consideration would depend upon the extent wireless acts as a substitute for primary wireline service.

**VOIP COMPETITION**

**Q. What is the state of VoIP competition in Arizona?**

A. Staff sent a data request[43] to all ILECs and CLECs in Arizona to understand the current state of VoIP services as provisioned by local exchange carriers. Of 31 ILECs and CLECs that responded, only **[redacted]** indicated any participation with some form of VoIP service in Arizona. Qwest indicated it has no operating agreements with providers of VoIP services and no knowledge of VoIP traffic interconnecting with its network.

I also made the same inquiry of the VoIP providers identified by Qwest in its application – Five Star, Vonage and Packet8. Vonage and Packet8, a.k.a, 8x8, Inc., indicated that VoIP services are being marketed in Arizona and that interconnection with the PSTN is being facilitated by agreements with select CLECs. Their responses also make clear that the

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[43] AFF 1.1 to AFF 1.5

current end-user base is very low. Vonage explained it has approximately 200,000 users in North America with Arizona constituting less than 10 percent of all subscribers.

AT&T announced[44] in July 2004 that it would be shifting its local telephony efforts to VoIP. *"...it is shifting its focus away from traditional consumer services such as wireline residential telephone services, and concentrating its growth efforts going forward on business markets and emerging technologies, such as Voice over Internet Protocol...."* At the same time, AT&T announced the availability of its VoIP, residential CallVantage$^{SM}$ Service in 100 markets nationwide. (see Exhibit AFF-12) As of September 8, 2004, CallVantage$^{SM}$ was available in Arizona 928, 480, and 520 area codes but not in 602 and 623. Given the flexibility afforded by VoIP, however, it may be possible for users in 602 and 623 to obtain VoIP service from AT&T by using numbers assigned to other NPAs, such as 928, 480, or 520.

MCI has been in various stages of VoIP deployment since mid-2003 when Fred Briggs[45], MCI President of Operations and Technology stated "By 2005, MCI plans to move 100 percent of our traffic to an all IP core..." MCI Advantage VoIP is available in all 115 U.S. metropolitan service areas where MCI owns local service facilities.

In August, 2004, Sprint announced[46] its third agreement in the last eight months in which it will help a cable provider offer telephone services using VoIP technology. In December 2003, Sprint agreed to provide VoIP services to Time Warner Cable, with 11 million cable customers nationally. Of the three cable providers which have agreements with Sprint -

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[44] AT&T news release, 7/22/04
[45] MCI news release, 6/3/03
[46] Associated Press, 8/12/04, "Sprint, Mediacom Announce VOIP Deal"

Mediacom, USA Companies of Kearney, NE or Time Warner Cable – only Mediacom has a presence in Arizona with a few small cable systems outside of Phoenix and Tucson.

In June, 2004, Qwest launched its Qwest OneFlex™ VoIP service for business customers, following with IP Centrex service in early September. Phoenix is one the four markets in which Qwest initially launched OneFlex™. (see Exhibit AFF-13)

While Cox is much larger than any other cable provider in Arizona, it is worth noting that others do exist and will ultimately be capable of facilitating, and even providing directly, VoIP services with their broadband services. Adelphia[47] provides service in Yuma and Cable America[48] provides service in Coolidge, Florence, Mesa, Queen Creek and Wickenburg.

**Q. Can the impact of VoIP service be seen in the listings information?**

A. I was unable to see any discrete listings information pertaining to VoIP services. This primarily results from two factors. (1) VoIP services are not regulated by the ACC as local exchange services. For that reason, VoIP providers are under no obligation to facilitate the local exchange listings or E-911 needs of end-users. **[redacted]**, for example, is believed to be helping VoIP providers with interconnection services, such as providing new telephone numbers and facilitating numbers being ported from CLECs or ILECs, however, **[redacted]** listings are not apparent in the listings information. (2) CLECs that may be self-provisioning VoIP services may not be separating their local exchange services number assignments from VoIP number assignments since practices do not exist for this requirement.

[47] http://www.adelphia.net/
[48] http://www.cableamerica.com/, http://www.cableaz.com/

I did perform one listings analysis test to provide more insight into part of the VoIP local situation. With the VoIP end-user's permission, I requested the listings ownership information from Qwest for a telephone number that was ported from Qwest to a CLEC facilitating service for a VoIP provider. The information provided by Qwest indicates that **[redacted]** is facilitating the provision of VoIP services to end-users. Other CLECs and, perhaps, Wireless providers and ILECs may also be helping to facilitate VoIP services. The facilitation could be done by any provider with a local switch that interconnects to the PSTN.

My analysis implies that the number of VoIP service end-users is very low at this time. The number of VoIP end-users in the listings database could be several thousand or could also be as low as 1 verified end-user. There really is no simple way to conclusively determine VoIP end-user levels at this time.

**Q. What are the major factors that drive VoIP deployment?**

A. There are a few startup costs associated with VoIP but they are relatively modest. One example is the phone adapter which is needed to allow analog phones to function with broadband service. While the analog phone adapter might cost $50 to $100, some providers, like Vonage, supply the adapter free to new customers. The most important factor is the availability of broadband technology, such as DSL, typically provided by ILECs and CLECs, or cable modems, typically provided by cable companies like Comcast and Cox Communications.

Cox Communications passes about **[redacted]** homes in the Phoenix metro area and about **[redacted]** homes in the Tucson metro area. All these homes are capable of receiving broadband service. Qwest is capable of providing broadband service to over **[redacted]** of all business or residence accounts in Phoenix and Tucson. In Phoenix, Qwest serves about **[redacted]** of its residence customers with broadband, in Tucson, the comparable figure is **[redacted]**. Cox did not provide its broadband penetration.

A surprising Nielsen survey[49] conducted in September 2004, concluded that 1.44 million broadband connections already exist in metro Phoenix. In that survey, Phoenix broadband connectivity was found to be second only to San Diego in the country's top 35 metro areas.

These figures suggest that the technological foundation for widespread acceptance of VoIP already exists. With the full resolution of operational factors that have bearing on the maintenance and monitoring[50] of VoIP service by providers, the only barriers confronting VoIP service are the absence of E-911, expanded broadband penetration and customer awareness.

It is worth noting that the recent FCC decision[51] that relieves the RBOCs of most obligations to unbundle fiber optic broadband local networks should help increase the availability of broadband needed for VoIP access as the RBOCs invest in fiber-to-the-home ("FTTH") and similar networks.

**Q. What is the projected future of VoIP service?**

A. Most projections regarding VoIP services are very optimistic. One of the most avid supporters is FCC Chairman Michael Powell. In May of this year, Chairman Powell told

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[49] The Arizona Republic, October 3, 2004, "Catching the Wave"
[50] TechNewsWorld.com, September 28, 2004, "VoIP Looms Large, But Problems Persist"
[51] FCC news release, October 14, 2004, "FCC Removes More Roadblocks To Broadband Deployment In Residential Neighborhoods"

the National Cable & Telecommunications Association's annual meeting in New Orleans[52] "I think it's going to turn (the telephone industry) on its head and remake itself into something that consumers are going to find enormously valuable,"

The cable companies are probably perceived on the leading edge of joining their broadband deployment with VoIP services. Time Warner has stated it expects to offer VoIP calling to all of its 10 million plus subscribers by end-of year 2004. In May, 2004, CNET News.com reported that "Cox once thought that it would save about 10 percent in capital expenses when choosing VoIP over circuit switches. But that savings is now about 40 percent." Reuters also reported in May, 2004, that Comcast, the nation's largest cable operator expects to offer VoIP service to half of its 21M subscribers by the end of 2005 and to 40 million households by end of 2006.

In May, 2004, the Rocky Mountain News reported[53] "An estimated 25 million homes in the United States have broadband, with cable modems accounting for more than 16 million connections vs. about 9 million for phone companies, which offer broadband through digital subscriber lines. The number of U.S. households with broadband is expected to increase by 8.5 million this year, a 30 percent spike."

A study by Mercer Management Consulting announced[54] in June 2004 "expects established ISPs to double their anticipated market share over what it called current low quality VoIP offerings over the next three years and grab up to 30 percent of the residential voice market."

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[52] National Cable & Telecommunications Association, May 4,2004, New Orleans, "Conversation with NCTA President Robert Sachs"
[53] Rocky Mountain News, May 5, 2004, VoIP Hailed as the Future
[54] Internetnews.com, June 15, 2004, Study Says Big Players to Dominate VoIP

In June, 2004, CNET News.com offered perhaps the most noteworthy announcement of all. "BT Group, a U.K. telecommunications provider, plans to transform its infrastructure into a pure Internet Protocol-based network by 2009." "BT[55] plans to begin mass migration from PSTN to IP in 2007. It is starting with a Voice over Internet Protocol, or VoIP, trial involving 1,500 customers this year."

With all the forecasts regarding wireline based VoIP services, it is easy to lose sight of the broadband capabilities that will be afforded by continuing advancements in wireless. End-users in less densely populated areas will be especially advantaged by such offerings. TeleSpectra, LLC, Network Service, for example, began providing broadband services in Wickenburg in July[56]. Once any form of broadband service is available, VoIP service is enabled.

This is just a sample of the announcements and forecasts concerning the future of VoIP. The weight of speculative evidence certainly tends to support VoIP competition. At this time, however, little factual evidence exists to support VoIP as a viable alternative to local exchange service.

**Q. Are there any downsides to VoIP competition?**

A. All of the positive industry support, bolstered by the FCC, tends to downplay operational problems that become more obvious as any new services begin to reach large scale deployment. It has come to Staff's attention that there are significant challenges in network management[57], similar in part to those which providers already using the PSTN have overcome. Full resolution of these challenges will require clear standards to

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[55] BT or BT Group is also known as British Telecom or British Telecommunications. In the UK, BT serves over 21 million corporate and residential customers with more than 28 million exchange lines.
[56] http://www.wickenburgsun.com/articles/2004/07/07/news/news08.txt
[57] TechNewsWorld.com, September 28, 2004, "VoIP Looms Large, But Problems Persist"

facilitate product development to manage and monitor complex services that must ultimately be billed quickly and accurately. Without overcoming these challenges, some believe that VoIP providers will have difficulty becoming profitable. This area of concern does not diminish from the ultimate potential for VoIP but does add further weight to the belief that VoIP is not yet a full alternative for local exchange service.

**Q. Is it possible to estimate an HHI with the inclusion of VoIP competition?**

A. The numerical information available for VoIP services is so limited that I am not able to include VoIP in an HHI measure. Even if the number of VoIP subscribers were known, the levels are likely too low at this time to have any impact on the HHI measure. Any HHI number that includes elements of VoIP would be highly speculative.

**Q. Please summarize your conclusions about the state of VoIP Competition in Arizona?**

A. (1) The telecommunications industry, in general, and the FCC, specifically, are very positive about the future of VoIP services.

(2) Major CLECs have announced plans to participate in VoIP competition.

(3) VoIP end-users cannot be found in the Listings information.

(4) VoIP service is dependent on the continuing penetration of broadband services which today is low at least for Qwest if its own figures are used.

(5) Some operating challenges appear to remain before VoIP service can become widely deployed to mass markets. Resolution of these challenges will require clear standards to facilitate product development to manage and monitor complex services that must ultimately be billed quickly and accurately

(6) Estimating HHIs with the inclusion of VoIP services is not feasible at this time.

(7) Qwest does not include VoIP in its competitive zone criteria. The available information suggests that further consideration is not warranted at this time. If VoIP

becomes more prevalent and acts as a substitute for local exchange services, it could be considered in an R14-2-1108 analysis in the future.

## CONSIDERATIONS RELATING TO QWEST'S PROPOSAL FOR COMPETITIVE ZONES

**Q. Where is Qwest requesting Competitive Zones?**

A. I should start by explaining that Qwest is requesting two wire center groups defined as Phoenix and Tucson MSAs. For clarification, there are 11 cities in the Phoenix MSA grouping that are not part of the Phoenix local calling area – Dudleyville, Kearney, Oracle, Florence, Mammoth, Superior, Coolidge, Eloy, Gila Bend, Casa Grande, and San Manuel. Five of these 11 towns – Dudleyville, Kearney, Oracle, Mammoth, and San Manuel - are also in the Tucson LATA, not the Phoenix LATA. For the purposes of my analysis and testimony, I continued with the Phoenix and Tucson MSA groupings as submitted by Qwest, therefore, you will see the 11 towns noted above within my Phoenix analysis data and associated with Phoenix in several of my exhibits.

Specifically, Qwest is requesting Competitive Zone classification for 63 wire centers in Phoenix metro and 19 wire centers in Tucson metro.

**Q. Is information available to allow for analysis of wire centers as competitive zones as proposed by Qwest?**

A. A general concern involves the measurement data parameters. Wire centers are historical, wireline, local exchange designations used by ILECs, such as Qwest. Since Qwest is the entity seeking competitive zones it seems fair to consider the parameters they propose, however, many new telecommunications entrants do not define their service areas on the same terms. Facilities bypass providers, not dependent on Qwest for unbundled elements or resale services, have no need to align their tracking systems to fit the wire center methodology of the incumbent local exchange carrier. Analyzing competitive information on the basis of Qwest's wire centers becomes problematic as the set of market participants broadens. Resale and UNE competitive options can be easily framed by wire center boundaries because the facilities are those of Qwest, the ILEC. Full bypass competition, however, has to be estimated or developed through special studies in order to fit wire center parameters unless the CLEC has chosen to mirror Qwest's wire center boundaries. The information fit becomes more extreme as wireless and VoIP competition are considered. In using the wire center parameters for areas that could be deemed competitive, there is a sense of trying to fit information derived from new and emerging competition into a measurement scheme intended to facilitate regulated services. Wireless and VoIP providers appear to make no use of Qwest's wire center boundaries. The only service location known for a wireless user is the nearest cell site. VoIP users are able to move their equipment and service to other broadband access points and, consequently, are also not restricted by physical boundaries. Therefore, evaluating competitive zones at the ILEC wire center level requires a full appreciation of the inherent measurement and analysis weaknesses associated with the available information.

It may be true that if competition can be easily defined and characterized within ILEC wire center parameters, then the competitive situation is by definition neither broad nor diverse. Confirming competition within ILEC wire centers parameters may actually be a confirmation of the least impactful forms of competition rather the most impactful.

**Q. Is there another methodology that should be considered by the Commission if it adopts competitive zones?**

A. No methodology appears perfect but one that appears to give the most flexibility is dependent on a geographic measure that is broadly accepted by many industries – the zip code. Zip codes are geographic definitions provided by the US Postal Service and used by all telecommunications providers for service and billing operations. Using zip code based information would allow competitive zone consideration at the highest level – statewide - or the lowest level – the discrete zip code – with several possibilities in between, such as city and county levels. Without use of zip code information, for example, analytical consideration of Qwest's related proposal for competitive zones defined by geographies other than wire centers, such as housing developments, is impractical. Housing developments may cross wire center boundaries or cover less than a full wire center. The use of zip code level information also lays the groundwork for the eventual inclusion of market information from emerging competitive alternatives, such as wireless and VoIP.

Staff initiated actions to obtain zip code level information for this proceeding but has been unable to conclude its analysis based on such information, as further explained in the testimony of Staff witness Matthew Rowell. Therefore, Staff has conducted its competitive zone analysis with traditional wire center information.

**Q. If the Commission were to adopt Qwest's first criteria[58] to determine competitive zones, in which wire centers do competitors have facilities in place?**

A. Information provided by Qwest in response to a RUCO data request points to 21 facilities-based CLECs (see Exhibit AFF-14) across Qwest wire centers. As explained earlier, Qwest's estimate of facilities-based competitors is based on its knowledge of LIS trunk information. Allowances must also be made for the timing of information provided. Some CLECs noted below appear to no longer be in service, such as Intermedia[59] and Winstar, and some CLECs, such as KMC Telecom, are not yet providing end-user service.

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[58] See Direct testimony of Matthew Rowell

[59] Thomas Dixon email, 10/12/04, "...Intermedia Communications while still holding a local CCN does not offer any local services and has no local customers or line counts..."

Still others, such as Level 3, are using LIS trunks but do not appear to be providing end-user services. The information is consistent, however, with the number of CLECs, explained earlier, having end-offices.

EXHIBIT AFF-14

| **Facilities Based CLECS** |
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Exhibit AFF-15 outlines the number of facilities-based CLECs by wire center derived from Qwest's LIS trunk information. Given the business concentration in Tucson Main and Phoenix Main, their relative ranking, 15 and 19 facilities-based CLECs respectively, is not a surprise. Using the 1st competitive zone measure proposed[60] by Qwest, 61 of the

[60] Qwest Revised Cap Plan, page 2, "A competitor has facilities in place and is marketing or offering services in competition with Qwest."

82 wire centers requested by Qwest would qualify based on the LIS trunk measurement. The remaining 21 wire centers requested by Qwest do not pass on this measure. (See Exhibit AFF-16)

**Q. Does this mean that all of these competitors are providing facilities-based local exchange service to residence and business customers in Qwest's service territory?**

A. No. Its worth emphasizing that some CLECs are no longer in service, as explained earlier, others are providing services that do not directly involve end-users and some may be serving business or residence customers but not both.

**Q. If the Commission were to adopt Qwest's second criteria[61] to determine competitive zones, in which wire centers are competitors utilizing unbundled network elements?**

A. Exhibit AFF-17 includes information for UNE-L, UNE-P and Resale competitors by wire center requested for competitive zone designation. This information was provided by Qwest in response to a RUCO data request[62]. Only 39 of the 82 wire centers requested have UNE-L CLECs, of which 30 are in the Phoenix MSA and 9 in the Tucson MSA. Surprisingly, all UNE-L competition as identified by the Qwest data response comes from only 9 CLECs. That only 9 of the 64 CLECs noted by Qwest as listed on the ACC's website or the 42 I found active in the Listings information were found to be participating in UNE-L competition reflects the general lack of acceptance of the UNE-L competitive option.

UNE-P presence can be seen in 80 of 82 wire centers requested for competitive zone designation. The two that do not exhibit UNE-P presence are Dudleyville and Whitlow, associated with Phoenix metro but well on the southeast perimeter. By the 2nd proposed

[61] See Direct testimony of Matthew Rowell
[62] RUCO DR #2

Qwest measure[63], UNE-P has more CLEC presence in wire centers than any type of competitive alternative. All UNE-P competition as identified by the Qwest data response comes from only 17 CLECs.

**Q. If the Commission were to adopt Qwest's third criteria[64] to determine competitive zones, where are competitors utilizing the resale of Qwest services?**

A. Exhibit AFF-17 also notes that competitive presence attributable to Resale can be found in 77 wire centers requested for competitive zone designation. Wire centers not seen with resale competition are Foothills, Rio Verde, Oracle, and Kearney, all associated with Phoenix metro, and Mt. Lemmon, associated with Tucson. In terms of just wire center presence, Resale is the second-highest form of competition, ranking between UNE-P in 80 wire centers and facilities-based CLECs in 61 wire centers. Related to the 3rd measure[65] proposed by Qwest, I found 28 CLECs participating in resale competition within the information provided by Qwest.

**Q. Can you summarize the CLEC presence in the wire centers requested by Qwest for competitive zone classification?**

A. Exhibit AFF-18 provides a comprehensive view of the CLECs and their form of competition in the wire centers requested for competitive zone classification, based on information provided by Qwest in response to a RUCO data request. If participation in all forms of competitive options is a measure of diverse competition, note that only three CLECS, AT&T, MCI and McLeodUSA, meet that standard in the wire center data provided by Qwest, yet, by the measures proposed by Qwest, all 82 wire centers would qualify as competitive zones. Exhibit AFF-19, however, provides more context for each

[63] Qwest Revised Cap Plan, page 2, "A competitor is marketing or offering services through the provision of unbundled network elements provided by Qwest"
[64] See Direct testimony of Matthew Rowell
[65] Qwest Revised Cap Plan, page 2, "A competitor is marketing or offering services through the resale of Qwest's service."

wire center. Note, for example, that Circle City, Dudleyville, Rio Verde, Gila Bend, Kearney, Mammoth, Oracle, Superior, Stanfield, White Tanks, Whitlow, Wintersburg, Mt. Lemmon, and Vail North – 14 of the wire centers requested - have considerably less CLEC presence than other wire centers. That points to low levels of competitive impact. In order to gauge impact, new measures such as market share, growth trends or actual losses have to be considered.

**Q. Can you put the competitive impacts and your concerns with Qwest's proposal in context?**

A. Exhibit AFF-20 begins to present a more complete picture at the wire center level. It is based on information submitted by Qwest in DLT-17[66] with responses to RUCO DR #2 and related analysis appended. As presented in Exhibit AFF-20, the information is sorted in order of Qwest wire center business line decline by Zones 1, 2, and 3 for Phoenix and Tucson areas. Simply studying the Qwest line changes for each wire center from EOY 2000 to EOY 2003 is very instructive. 21 UNE Zone 1 wire centers in the Phoenix MSA have Qwest declines of more than **[redacted]** over the 2000 to 2003 period with an additional 7 wire centers in Zones 2 and 3. Tucson has a total of 7 wire centers that meet this standard. The comparable figures for residence are 28 UNE Zone 1 wire centers in Phoenix with an additional 4 in Zones 2 and 3. Tucson has a total of 11 wire centers with residence declines in excess of **[redacted]**.

Other columns in this exhibit give the line changes additional context. For example, how is it possible that Phoenix North wire center business lines have declined **[redacted]** in the three year period while Qwest's market share is estimated at **[redacted]**? Here is one possibility. Assuming that all the data are reasonably correct, it is possible that the proportion of business lines to residence lines is comparatively small. Phoenix South

[66] Revised per Qwest's response to DR 3.15

might have a very high proportion of residence lines since it has declined **[redacted]** in residence lines but is at **[redacted]** in market share. The type of loss can help give some context to the sustainability of the competitive presence. For example, 9 wire centers had business or residence declines for Qwest greater than **[redacted]** during the three year period but have no facilities bypass CLECs. Does that seem possible? Studying this further you see that all 9 wire centers are in UNE Zone 3. Some judgment must then be given to the sustainability of the competitive activity given the uncertainty of competition based on Resale and UNE options. The timing of the information may be highlighted by the Phoenix Main data. Notice that the business and residence line declines from 2000 to 2003 are **[redacted]** and **[redacted]** respectively, while Qwest's market share is **[redacted]** How is that possible? Absent data concerns, one answer is that a considerable amount of competition in Phoenix Main occurred between 1996 and 2000, previous to the three year period of 2000 to 2003. Given the early focus on business by CLECs, it is logical to assume that wire centers dominated by business lines may be reaching or have reached a competitive steady-state. There is a point, however, at which data concerns regarding the translation of LIS trunks to line loss estimates must be considered. The San Manuel wire center, for example, indicates a CLEC market share of **[redacted]** San Manuel also happens to be 1 of only 3 wire centers with facilities competition in the 19 wire centers with total Qwest lines of 5,000 or below. In the other two wire centers, Laveeen and Vail South, Qwest's business and residence line changes are positive over three year period, making San Manuel unique. Further analysis, discloses that **[redacted]** of the **[redacted]** line decline is attributable to the LIS trunk translation to facilities line loss estimate corresponding to one CLEC. This helps illustrate how information based on estimates can be problematic for analysis and raises the importance of proper context.

**Q. Are there areas below the wire center level that could be considered as Qwest requests in its application?**

A. As suggested in Qwest's application, Staff sought to understand the competitive situation pertaining to the identified housing developments. This effort helps illustrate the issues involved with non-traditional local exchange parameters. Staff issued a data request on August 19, 2004 to Qwest and the 10 CLECs identified in Qwest's May 20, 2004 application. Among the CLECs, only Cox responded in substantial form. All others answered that they were unable to track customers by housing development name[67].

Cox provided information related to 9 housing developments, 5 of which have agreements with Qwest. Qwest supplied information for 10 developments, 2 of which have agreements with Cox. Cox does not have customers in 10 of 15 developments in which Qwest has agreements. Qwest does not have customers in 12 of 14 developments in which Cox has agreements. While Qwest and Cox residence service figures are very similar, only Qwest reported serving business customers in any housing developments.

Limited information makes it impossible to analyze the competitive situation concerning housing developments, which may have signed preferred marketing and/or limited operating agreements with either Cox or Qwest. A few points stand out. (1) Cox and Qwest appear to be serving a similar number of housing developments with preferred agreements that do not preclude competitive offerings but may constrain marketing efforts by other CLECs. (2) Both Cox and Qwest appear to be making efforts to compete for customers in housing developments[68] in which they do not have preferred agreements, not just developments in which they do have preferred agreements. (3) Many of the housing developments with preferred agreements appear to be in early stages of development and are not being served by either Cox or Qwest at this time.

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[67] Housing development names were provided by Qwest in response to DR 3.10
[68] Qwest did not provide copies of housing agreements in response to STF 20.3

While Staff intends to open a generic docket to examine the issue of preferred provider agreements, Staff sees no reason why Qwest should not be allowed to seek competitive designations for smaller locations such as housing developments, subject to the limitations and concerns noted in Mr. Rowell's testimony.

**Q. Please summarize your concerns regarding the classification of competitive zones based only upon the presence of a competitor in a wire center, as proposed by Qwest?**

A. The wire center information available from Qwest might lead to some conclusions if evaluated on a standalone basis but in the context of additional information, conclusions become difficult. Here are a few examples.

My wire center level analysis based on information provided by Qwest identified one wire center with an HHI of 1,319 – Phoenix Main. Given my earlier discussion of HHIs, Phoenix Main would appear to be an ideal candidate for competitive zone classification, however, closer inspection of the Phoenix Main information begins to raise questions. The composition of CLECs in Phoenix Main is heavily skewed towards facilities bypass competition making the LIS trunk estimate translation to lines especially important. The first observation from Exhibit AFF-21[69] that must be noted is the number of CLECs with significant numbers of lines which are included in Phoenix Main as facilities providers but not participating in end-user local exchange service - Level 3, Intermedia, and Winstar, for example. These three constitute a total estimate of **[redacted]** in Qwest's wire center competitive loss information. Global Crossing is shown as having **[redacted]** lines but does not appear in the listing data at all. North County is shown as having **[redacted]** lines but indicated directly to Staff that it does not provide end-user services. Pac-West is shown as having **[redacted]** lines but has only **[redacted]** main listings. While it may be

[69] CLEC names in Exhibit AFF-20 are shown as included in the Qwest data response to RUCO DR#2

possible, Pac-West's [redacted] ratio of total lines to main lines is difficult to accept without supporting information. Just by examining more closely the type of competition raises questions about [redacted] facilities bypass lines or [redacted] of the entire facilities bypass estimate.

Utilizing the zip code information provided by five key competitors – Cox, AT&T[70], MCI, Mountain Tel and Eschelon – adds more context. Notice in Exhibit AFF-21 that the facilities bypass estimated figures for these five CLECs totals [redacted]. By comparison, the zip code information provided by the five CLECs and mapped to the Phoenix Main zip codes[71] totals only [redacted] (Exhibit AFF-22), a reduction of [redacted] lines.

By examining more closely the type of competitors and considering the zip code information submitted by only five CLECs, [redacted] of the total wire center competitive figures from Qwest are drawn into question. This helps illustrate the analysis value that could be gained by *all* CLECs providing zip code level information. At issue is not which estimate methodology is most useful but that more than one methodology must be used when exact figures are not available. The Qwest wire center information is, perhaps, based on too broad[72] an estimate without exactness for the type of competition.

Exhibit AFF-22

Phoenix Main Wire Center

[70] AT&T only provided residence lines by zip code

[71] Wire center zip code definitions provided by Qwest in response to STF 33.1

[72] Qwest used a translation figure of 2.75 which could be as high as 10. "...this is a conservative assumption...a single trunk can support up to approximately 10 facilities-based lines (source: UNE Fact Report, Section III, P. 14, May 26, 1999)"

| Zip Code | Percentage of Sqmiles of Zipcode within Wire Center | Non-Q bus & res lines | Derived non-Q bus & res lines |
|---|---|---|---|
| [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] |
| | | [redacted] | [redacted] |

I can offer examples that highlight potential candidates for competitive zones that are not easily identified by the Qwest wire center information. The Higley wire center has an HHI of 6,259 based on Qwest's wire center information. The zip code referenced above, however, when mapped against Higley's zip codes yields surprising results. Qwest's wire center information suggests a market share loss of **[redacted]** but the zip code information, even in limited form, suggests Qwest has lost **[redacted]** share. While the estimated information based on LIS trunks used for Phoenix Main may have been too high, the estimated information for Higley may be too low.

Exhibit AFF-23

Higley Wire Center

| Zip Code | Percentage of Sqmiles of Zipcode within Wire Center | Non-Q bus & res lines | Derived non-Q bus & res lines |
|---|---|---|---|
| [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] |

| | | | |
|---|---|---|---|
| [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] |
| | | | [redacted] |

Another example illustrates the most powerful value that may be gained from the zip code information. Consider the wire center analysis dilution that occurs when a highly competitive area is spread across more than one wire center. Such appears to be the case for Vail North, in southeast Tucson metro. Using Qwest's wire center information, Vail North only has an HHI of 9,756 with a market share loss of [redacted]. This would appear to suggest that Vail North is far from competitive. Qwest does not even appear to believe that Cox has a competitive presence in Vail North[73]. The available zip code information, however, discloses that Qwest *may have* a share loss of [redacted] in Vail North. The zip codes that have the greatest impact on Vail North's data are [redacted], [redacted] and [redacted]. These zip codes are found in a total of 9 wire centers dramatizing the importance of analyzing information in a non-traditional, non-ILEC manner.

Exhibit AFF-24

Vail North Wire Center

| Zip Code | Percentage of Sqmiles of Zipcode within Wire Center | Non-Q bus & res lines | Derived non-Q bus & res lines |
|---|---|---|---|
| [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] |
| | | | [redacted] |

[73] Qwest exhibit DLT-17

Despite devoting considerable effort to the zip code approach, I would like to emphasize no approach is perfect. Like wire centers, zip codes vary greatly in size and estimates would still result from the mapping of information across wire centers. The most important factor is ensuring that all CLECs supply information based on service address zip codes, not billing address zip codes. It is my belief, however, that the results are more likely to truly reflect market conditions, and offer a means to include emerging technologies, such as Wireless and VoIP.

**Q. What is your recommendation for continuing measurement and analysis of competitive zones?**

A. I have presented analysis in my testimony from various sources to lend the most context possible to the competitive situation. I believe, however, that much greater confidence and reliability could be added by moving from traditional ILEC geographic boundaries to a relatively simple measure used not only in telecommunications but in all industries – zip codes. I recommend the following actions.

(1) With the availability of local exchange business and residence customers and corresponding local exchange business and residence access lines by service address zip codes, a comprehensive geographic analysis could be conducted including data from Qwest, CLECs and even Wireless[74] providers adding increased confidence and certainty to any decision made by the Commission regarding competitive zones. The zip code information could be aggregated at any level needed to support Commission decisions.

(2) This methodology could be put in place to facilitate future competitive zone considerations by adding the submission of service address zip code level information to the existing annual report requirements of all providers.

[74] Only billing zip codes are known to be available for Wireless service.

(3) I also recommend continuing analysis of listings information as illustrated earlier in my testimony to provide a broad perspective of the competitive situation based on end-user information. As described earlier, the listings information is essentially a 100 percent sample of the end-user customer base and could be available for analysis at convenient periods co-incident with updates required for operational needs driven by customer listing submissions from ILECs and CLECs.

(4) I also recommend that consideration be given to tracking MOUs. Analysis of the competitive situation can be most proactive when done with leading indicators. Revenues and lines provide critical information but are really lagging indicators. For a multitude of reasons, customers may subscribe to a mix of ILEC, CLEC, Wireless and, perhaps even, VoIP services. Real-time usage of such services, however, is a leading indicator of the value placed on services by end-users. For example, even if local exchange lines are not currently being displaced by wireless, an increasing shift in MOUs, or usage, would strongly suggest a shift in value by end-users that should inevitably translate into line and revenue line shifts. Rather than just considering the competitive situation of local exchange services based on customer and line actuals, the Commission should have the option to consider if the <u>value</u> of local exchange services is shifting. This option, however, will require that providers track and make available usage information in a comparable format.

**Q. Does this conclude your direct testimony?**

A. Yes, it does.

**EXHIBITS**

| | |
|---|---|
| AFF-1 | CLECS in Listings Information |
| AFF-6 | Switches & NPA-NXXs |
| AFF-9 | HHI Estimates Based on Listings & Lines |
| AFF-11 | HHI Estimates with Wireless |
| AFF-12 | AT&T CallVantage$^{SM}$ Service |
| AFF-13 | Qwest OneFlex |
| AFF-15 | Wire Centers with Facilities CLECs |
| AFF-16 | Wire Centers without Facilities CLECs |
| AFF-17 | Wire Centers with Resale & UNE CLECs |
| AFF-18 | CLECs by Type of Competition |
| AFF-19 | All Wire Centers with All Types of CLECs |
| AFF-20 | Wire Center Summary by UNE Zone & Qwest Line Decline '00-'03 |
| AFF-21 | Phoenix Main Wire Center |

EXHIBIT AFF-1 CLECs in Listings Information

Company Name

| | |
|---|---|
| [REDACTED] | [REDACTED] |
| [REDACTED] | [REDACTED] |
| [REDACTED] | [REDACTED] |
| [REDACTED] | [REDACTED] |
| [REDACTED] | [REDACTED] |
| [REDACTED] | [REDACTED] |
| [REDACTED] | [REDACTED] |
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| [REDACTED] | [REDACTED] |
| [REDACTED] | [REDACTED] |
| [REDACTED] | [REDACTED] |
| [REDACTED] | [REDACTED] |
| [REDACTED] | [REDACTED] |

EXHIBIT AFF-6 Switches & NPA-NXXs

| | DS Switches | | | | | Remote Switches | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Phoenix 480 | 602 | 623 | Tucson 520 | Total DS Switches | Phoenix 480 | 602 | 623 | Tucson 520 | Total Remotes |
| Qwest | | | | | [redacted] | | | | | |
| AT&T | | | | | [redacted] | | | | | |
| Cox | | | | | [redacted] | | | | | |
| Eschelon | | | | | [redacted] | | | | | |
| MCI | | | | | [redacted] | | | | | |
| McLeodUSA | | | | | [redacted] | | | | | |
| SBC | | | | | [redacted] | | | | | |
| Sprint | | | | | [redacted] | | | | | |
| XO | | | | | [redacted] | | | | | |
| Xspedius | | | | | [redacted] | | | | | |
| Z Tel | | | | | [redacted] | | | | | |
| Totals | | | | | [redacted] | | | | | |
| Non-Qwest | | | | | [redacted] | | | | | |

| | NPA NXXs | | | | | |
|---|---|---|---|---|---|---|
| | 480 | 602 | 623 | 520 | Total NXXs | Ave NXXs per DS Switches & Remotes |
| Qwest | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| AT&T | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Cox | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Eschelon | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| MCI | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| McLeodUSA | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| SBC | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Sprint | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| XO | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Xspedius | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Z Tel | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Totals | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Non-Qwest | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |

EXHIBIT AFF-9 HHI Estimates Based on Listings & Lines

| | HHI, based on listings Business Mains | HHI, based on listings Residence Mains |
|---|---|---|
| Phoenix (480,602,623) | 5,916 | 5,529 |
| Tucson (520) | 7,168 | 7,292 |

| | Number of CLECs Business Mains | Number of CLECs Residence Mains |
|---|---|---|
| Phoenix (480,602,623) | 30 | 35 |
| Tucson (520) | 23 | 26 |

| | CLECs w >=0.1% share listings Business Mains | CLECs w >=0.1% share listings Residence Mains |
|---|---|---|
| Phoenix (480,602,623) | 15 | 7 |
| Tucson (520) | 13 | 6 |

EXHIBIT AFF-11 HHI Estimates with Wireless

Statewide HHI Based on Qwest Listings, CLECs Listings and Wireless estimates

| | Business | Residence |
|---|---|---|
| HHI | 3,825 | 4,747 |

Key Assumptions

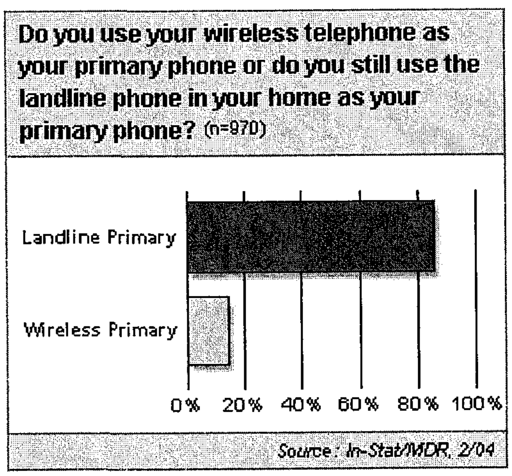
* 2,843,061 Wireless Subs per FCC
* 90% of Wireless Subs in Qwest areas
* Displacement 80% Residence
* Displacement 20% Business

Statewide HHI Based on Lines for Qwest, CLECs, & Wireless

| | |
|---|---|
| HHI | 3,624 |

Key Assumptions

* 2,843,061 Wireless Subs per FCC
* 30% additional line displacement
* 852,918 total line displacement



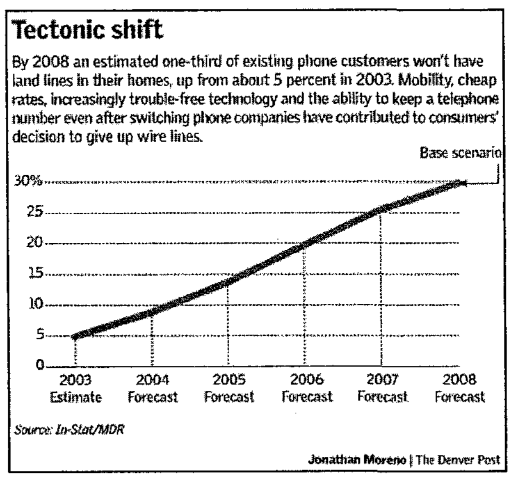



EXHIBIT AFF-12 AT&T CallVantage$^{SM}$ Service

**From http://www.usa.att.com/callvantage/order/upcoming_markets.jsp**

**September 8, 2004**

**AT&T CallVantage$^{SM}$ Service numbers are available now in the following states.**

| | |
|---|---|
| Alabama | Nebraska |
| Arizona | New Hampshire |
| California | New Jersey |
| Colorado | New Mexico |
| Connecticut | New York |
| Delaware | North Carolina |
| Florida | Ohio |
| Georgia | Oklahoma |
| Illinois | Oregon |
| Indiana | Pennsylvania |
| Iowa | Rhode Island |
| Kansas | South Carolina |
| Kentucky | Tennessee |
| Louisiana | Texas |
| Maryland | Virginia |
| Massachusetts | Washington |
| Michigan | Washington DC |
| Minnesota | Wisconsin |
| Missouri | |

EXHIBIT AFF-13 Qwest OneFlex

http://www.qwest.com/about/media/pressroom/1,1720,1550_archive,00.html?printVersion=1&xmlFilename=2004Jun231550&storyId=1550

June 23, 2004

Qwest OneFlex will be available to business customers in Boise, Idaho, Denver, Minneapolis and Phoenix in mid-July. By the end of 2004, customers in the following metropolitan areas will also have the benefits of Qwest OneFlex:

- Albuquerque, N.M.
- Baltimore
- Billings, Mont.
- Bismarck, N.D.
- Boston
- Casper, Wyo.
- Chicago
- Columbus, Ohio
- Des Moines, Iowa
- Los Angeles
- New York
- Omaha, Neb.
- Orange County, Calif.
- Philadelphia
- Portland, Ore.
- Salt Lake City
- San Diego
- San Francisco
- San Jose, Calif.
- Seattle
- Sioux Falls, S.D.
- Washington, D.C.

Qwest will continue to expand OneFlex to additional markets in 2005.

EXHIBIT AFF-15 Wire Centers with Facilities CLECs

| Area | Wire Center | CLLI | # of Facilities CLECs |
|---|---|---|---|
| Tucson | TUCSON-MAIN | TCSNAZMA | [redacted] |
| Tucson | TUCSON-EAST | TCSNAZEA | [redacted] |
| Tucson | CATALINA | TCSNAZCA | [redacted] |
| Tucson | CORTARO | TCSNAZCO | [redacted] |
| Tucson | CRAYCROFT | TCSNAZCR | [redacted] |
| Tucson | FLOWING-WELLS | TCSNAZFW | [redacted] |
| Tucson | GREEN VALLEY | GNVYAZMA | [redacted] |
| Tucson | RINCON | TCSNAZRN | [redacted] |
| Tucson | TANQUE VERDE | TCSNAZTV | [redacted] |
| Tucson | TUCSON-NORTH | TCSNAZNO | [redacted] |
| Tucson | TUCSON-SOUTH | TCSNAZSO | [redacted] |
| Tucson | CORONADO | CRNDAZMA | [redacted] |
| Tucson | TUCSON SOUTHWEST | TCSNAZSW | [redacted] |
| Tucson | TUCSON SE | TCSNAZSE | [redacted] |
| Tucson | VAIL SOUTH | VAILAZSO | [redacted] |
| Phoenix | PHOENIX-MAIN | PHNXAZMA | [redacted] |
| Phoenix | PHOENIX-SOUTHEAST | PHNXAZSE | [redacted] |
| Phoenix | PHOENIX-NORTH | PHNXAZNO | [redacted] |
| Phoenix | SCOTTSDALE | SCDLAZMA | [redacted] |
| Phoenix | TEMPE-MAIN | TEMPAZMA | [redacted] |
| Phoenix | PHOENIX-CACTUS | PHNXAZCA | [redacted] |
| Phoenix | PHOENIX-GREENWAY | PHNXAZGR | [redacted] |
| Phoenix | PHOENIX-SUNNYSLOPE | PHNXAZSY | [redacted] |
| Phoenix | TEMPE-MCCLINTOCK | TEMPAZMC | [redacted] |
| Phoenix | BEARDSLEY | BRDSAZMA | [redacted] |
| Phoenix | GILBERT | MESAAZGI | [redacted] |
| Phoenix | GLENDALE-MAIN | GLDLAZMA | [redacted] |
| Phoenix | MESA-MAIN | MESAAZMA | [redacted] |
| Phoenix | PHOENIX-EAST | PHNXAZEA | [redacted] |
| Phoenix | PHOENIX-MID RIVERS | PHNXAZMR | [redacted] |
| Phoenix | PHOENIX-NORTHEAST | PHNXAZNE | [redacted] |
| Phoenix | PHOENIX-PEORIA | PHNXAZPR | [redacted] |
| Phoenix | SUPERSTITION-WEST | SPRSAZWE | [redacted] |
| Phoenix | THUNDERBIRD | SCDLAZTH | [redacted] |
| Phoenix | CHANDLER-MAIN | CHNDAZMA | [redacted] |
| Phoenix | CHANDLER-WEST | CHNDAZWE | [redacted] |
| Phoenix | DEER VALLEY NORTH | DRVYAZNO | [redacted] |
| Phoenix | PHOENIX-BETHANY WEST | PHNXAZBW | [redacted] |

| Area | Wire Center | CLLI | # of Facilities CLECs |
|---|---|---|---|
| Phoenix | PHOENIX-MARYVALE | PHNXAZMY | [redacted] |
| Phoenix | PHOENIX-NORTHWEST | PHNXAZNW | [redacted] |
| Phoenix | PHOENIX-SOUTH | PHNXAZSO | [redacted] |
| Phoenix | PHOENIX-WEST | PHNXAZWE | [redacted] |
| Phoenix | PINNACLE PEAK | PRVYAZPP | [redacted] |
| Phoenix | SHEA | SCDLAZSH | [redacted] |
| Phoenix | SUPERSTITION-MAIN | SPRSAZMA | [redacted] |
| Phoenix | CAVE CREEK | CVCKAZMA | [redacted] |
| Phoenix | CHANDLER-SOUTH | CHNDAZSO | [redacted] |
| Phoenix | COLDWATER | GDYRAZCW | [redacted] |
| Phoenix | LITCHFIELD PARK | LTPKAZMA | [redacted] |
| Phoenix | SUPERSTITION-EAST | SPRSAZEA | [redacted] |
| Phoenix | FORT MCDOWELL | FTMDAZMA | [redacted] |
| Phoenix | PHOENIX-PECOS | PHNXAZPP | [redacted] |
| Phoenix | HIGLEY | HGLYAZMA | [redacted] |
| Phoenix | PHOENIX-FOOTHILLS | PHNXAZ81 | [redacted] |
| Phoenix | TOLLESON | TLSNAZMA | [redacted] |
| Phoenix | HGLY QUEEN CREEK | HGLYAZQC | [redacted] |
| Phoenix | NEW RIVER | NWRVAZMA | [redacted] |
| Phoenix | BUCKEYE | BCKYAZMA | [redacted] |
| Phoenix | PHOENIX-LAVEEN | PHNXAZLV | [redacted] |
| Phoenix | CASA GRANDE | CSGRAZMA | [redacted] |
| Phoenix | SAN MANUEL | SNMNAZMA | [redacted] |
| Other | SUNRISE | AGFIAZSR | [redacted] |
| Other | FLAGSTAFF EAST | FLGSAZEA | [redacted] |
| Other | FLAGSTAFF MAIN | FLGSAZMA | [redacted] |
| Other | SIERRA VISTA-MN | SRVSAZMA | [redacted] |
| Other | YUMA FORTUNA | YUMAAZFT | [redacted] |
| Other | YUMA-MAIN | YUMAAZMA | [redacted] |
| Other | YUMA-SOUTHEAST | YUMAAZSE | [redacted] |
| Other | CHINO VALLEY | CHVYAZMA | [redacted] |
| Other | NOGALES MIDWAY | NGLSAZMW | [redacted] |
| Other | PRESCOTT MAIN | PRSCAZMA | [redacted] |
| Other | SIERRA VISTA SO | SRVSAZSO | [redacted] |
| Other | COTTONWOOD-MAIN | CTWDAZMA | [redacted] |
| Other | SEDONA-MAIN | SEDNAZMA | [redacted] |
| Other | MUNDS PARK | MSPKAZMA | [redacted] |
| Other | PAYSON | PYSNAZMA | [redacted] |
| Other | SAFFORD | SFFRAZMA | [redacted] |

EXHIBIT AFF-16 Wire Centers without Facilities CLECs

| Area | Wire Centers | CLLI |
|---|---|---|
| [redacted] | [redacted] | [REDACTED] |
| [redacted] | [redacted] | [REDACTED] |
| [redacted] | [redacted] | [REDACTED] |
| [redacted] | [redacted] | [REDACTED] |
| [redacted] | [redacted] | [REDACTED] |
| [redacted] | [redacted] | [REDACTED] |
| [redacted] | [redacted] | [REDACTED] |
| [redacted] | [redacted] | [REDACTED] |
| [redacted] | [redacted] | [REDACTED] |
| [redacted] | [redacted] | [REDACTED] |
| [redacted] | [redacted] | [REDACTED] |
| [redacted] | [redacted] | [REDACTED] |
| [redacted] | [redacted] | [REDACTED] |
| [redacted] | [redacted] | [REDACTED] |
| [redacted] | [redacted] | [REDACTED] |
| [redacted] | [redacted] | [REDACTED] |
| [redacted] | [redacted] | [REDACTED] |
| [redacted] | [redacted] | [REDACTED] |
| [redacted] | [redacted] | [REDACTED] |
| [redacted] | [redacted] | [REDACTED] |
| [redacted] | [redacted] | [REDACTED] |

EXHIBIT AFF-17 Wire Centers with Resale & UNE CLECs

| Area | Wire Center | CLLI | UNE-L CLECs | UNE-P CLECs | Resale CLECs |
|---|---|---|---|---|---|
| Phoenix | Cactus (Phoenix) | PHNXAZCA | [redacted] | [redacted] | [redacted] |
| Phoenix | Phoenix Main | PHNXAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Phoenix Northeast | PHNXAZNE | [redacted] | [redacted] | [redacted] |
| Phoenix | Phoenix North | PHNXAZNO | [redacted] | [redacted] | [redacted] |
| Phoenix | McClintock (Tempe) | TEMPAZMC | [redacted] | [redacted] | [redacted] |
| Phoenix | Peoria (Phoenix) | PHNXAZPR | [redacted] | [redacted] | [redacted] |
| Phoenix | Phoenix South | PHNXAZSO | [redacted] | [redacted] | [redacted] |
| Phoenix | Mesa | MESAAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Sunnyslope (Phoenix) | PHNXAZSY | [redacted] | [redacted] | [redacted] |
| Phoenix | Scottsdale Main | SCDLAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Thunderbird (Scottsdale) | SCDLAZTH | [redacted] | [redacted] | [redacted] |
| Phoenix | Phoenix Southeast | PHNXAZSE | [redacted] | [redacted] | [redacted] |
| Phoenix | Phoenix West | PHNXAZWE | [redacted] | [redacted] | [redacted] |
| Phoenix | Chandler West | CHNDAZWE | [redacted] | [redacted] | [redacted] |
| Phoenix | Gilbert (Mesa) | MESAAZGI | [redacted] | [redacted] | [redacted] |
| Phoenix | Deer Valley | DRVYAZNO | [redacted] | [redacted] | [redacted] |
| Phoenix | Super West | SPRSAZWE | [redacted] | [redacted] | [redacted] |
| Phoenix | Chandler Main | CHNDAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Tempe | TEMPAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Phoenix East | PHNXAZEA | [redacted] | [redacted] | [redacted] |
| Phoenix | Greenway (Phoenix) | PHNXAZGR | [redacted] | [redacted] | [redacted] |
| Phoenix | Glendale | GLDLAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Casa Grande | CSGRAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Maryvale (Phoenix) | PHNXAZMY | [redacted] | [redacted] | [redacted] |
| Phoenix | Beardsley | BRDSAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Super Main | SPRSAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Phoenix Northwest | PHNXAZNW | [redacted] | [redacted] | [redacted] |

| Area | Wire Center | CLLI | UNE-L CLECs | UNE-P CLECs | Resale CLECs |
|---|---|---|---|---|---|
| Phoenix | Shea (Scottsdale) | SCDLAZSH | [redacted] | [redacted] | [redacted] |
| Phoenix | Mid Rivers (Phoenix) | PHNXAZMR | [redacted] | [redacted] | [redacted] |
| Phoenix | Foothills | PHNXAZ81 | [redacted] | [redacted] | [redacted] |
| Phoenix | Bethany West (Phoenix) | PHNXAZBW | [redacted] | [redacted] | [redacted] |
| Phoenix | Pecos (Phoenix) | PHNXAZPP | [redacted] | [redacted] | [redacted] |
| Phoenix | Queen Creek (Higley) | HGLYAZQC | [redacted] | [redacted] | [redacted] |
| Phoenix | Super East | SPRSAZEA | [redacted] | [redacted] | [redacted] |
| Phoenix | Coldwater (Goodyear) | GDYRAZCW | [redacted] | [redacted] | [redacted] |
| Phoenix | Pinnacle Peak | PRVYAZPP | [redacted] | [redacted] | [redacted] |
| Phoenix | Chandler South | CHNDAZSO | [redacted] | [redacted] | [redacted] |
| Phoenix | Ft. McDowell | FTMDAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Litchfield Park | LTPKAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Cave Creek | CVCKAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Higley | HGLYAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | New River | NWRVAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Tolleson | TLSNAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Buckeye | BCKYAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Laveen (Phoenix) | PHNXAZLV | [redacted] | [redacted] | [redacted] |

| | | | | | |
|---|---|---|---|---|---|
| Phoenix | Eloy | ELOYAZ01 | [redacted] | [redacted] | [redacted] |
| Phoenix | Wickenburg | WCBGAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Coolidge | CLDGAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Maricopa | MRCPAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Gila Bend | GLBNAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | White Tanks | WHTKAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Circle City | CRCYAZNM | [redacted] | [redacted] | [redacted] |
| Phoenix | Florence | FLRNAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Rio Verde | FTMDAZNO | [redacted] | [redacted] | [redacted] |
| Phoenix | Oracle | ORCLAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Wintersburg | WNBGAZ01 | [redacted] | [redacted] | [redacted] |
| Phoenix | Kearny | KRNYAZMA | [redacted] | [redacted] | [redacted] |

| Area | Wire Center | CLLI | UNE-L CLECs | UNE-P CLECs | Resale CLECs |
|---|---|---|---|---|---|
| Phoenix | Mammoth | MMTHAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | San Manuel | SNMNAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Superior | SPRRAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Stanfield | STFDAZMA | [redacted] | [redacted] | [redacted] |
| Phoenix | Dudleyville | DDVLAZNM | [redacted] | [redacted] | [redacted] |
| Phoenix | Whitlow | WHTLAZMA | [redacted] | [redacted] | [redacted] |
| Tucson | Tucson Main | TCSNAZMA | [redacted] | [redacted] | [redacted] |
| Tucson | Craycroft (Tucson) | TCSNAZCR | [redacted] | [redacted] | [redacted] |
| Tucson | Flowing Wells (Tucson) | TCSNAZFW | [redacted] | [redacted] | [redacted] |
| Tucson | Rincon (Tucson) | TCSNAZRN | [redacted] | [redacted] | [redacted] |
| Tucson | Tucson South | TCSNAZSO | [redacted] | [redacted] | [redacted] |
| Tucson | Tucson East | TCSNAZEA | [redacted] | [redacted] | [redacted] |
| Tucson | Tucson North | TCSNAZNO | [redacted] | [redacted] | [redacted] |
| Tucson | Catalina (Tucson) | TCSNAZCA | [redacted] | [redacted] | [redacted] |
| Tucson | Cortaro (Tucson) | TCSNAZCO | [redacted] | [redacted] | [redacted] |
| Tucson | Tucson Southeast | TCSNAZSE | [redacted] | [redacted] | [redacted] |
| Tucson | Coronado | CRNDAZMA | [redacted] | [redacted] | [redacted] |
| Tucson | Tanque Verde (Tucson) | TCSNAZTV | [redacted] | [redacted] | [redacted] |
| Tucson | Tucson Southwest | TCSNAZSW | [redacted] | [redacted] | [redacted] |
| Tucson | Green Valley | GNVYAZMA | [redacted] | [redacted] | [redacted] |
| Tucson | Marana | MARNAZMA | [redacted] | [redacted] | [redacted] |
| Tucson | Tucson West | TCSNAZWE | [redacted] | [redacted] | [redacted] |
| Tucson | Vail South | VAILAZSO | [redacted] | [redacted] | [redacted] |
| Tucson | Vail North | VAILAZNO | [redacted] | [redacted] | [redacted] |
| Tucson | Mt. Lemmon (Tucson) | TCSNAZML | [redacted] | [redacted] | |

EXHIBIT AFF-18 CLECs by Type of Competition

| | Type of Competition | | | | |
|---|---|---|---|---|---|
| CLEC Name | Facilities | UNE-L | UNE-P | Resale | All |
| 1-800-RECONEX Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| ACN Communications Services Inc | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Allegiance Telecom Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Arizona Dial Tone | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| AT&T | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Brooks Fiber Communications Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Budget Phone Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Buy-Tel Communications Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| CapRock Telecommunications Corp. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Comm South Companies Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Cox Telcom L.L.C. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Cypress Communications | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| DPI Teleconnect L.L.C. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Electric Lightwave, Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Ernest Communications Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Eschelon Telecom Inc | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Excel Telecommunications Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Global Crossing Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Granite Telecommunications LLC | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Intermedia Communications Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| KMC Telecom Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Level 3 Communications LLC | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| MCI | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| McLeodUSA | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Mountain Telecommunications | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| North County Communications | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| NOS Communications Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Pac-West Telecomm Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Preferred Carrier Services Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Quality Telephone | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| QuantumShift Communications Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Regal Telephone Company | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| SBC Telecom Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| ServiSense.Com Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Sprint Communications Company L.P. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Tel West Communications LLC | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Time Warner Telecom Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| VarTec Telecom Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Verizon Avenue | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Winstar Communications LLC | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| XO Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Xspedius Communications | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Z-Tel Communications Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |

EXHIBIT AFF-19 All Wire Centers with All Types of CLECs

| | | | Number of CLECs | | | |
|---|---|---|---|---|---|---|
| Area | Wire Center | CLLI Code | UNE-L | UNE-P | Resale | Facilities |
| Phoenix | Buckeye | BCKYAZMARS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Beardsley | BRDSAZMADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Chandler Main | CHNDAZMADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Chandler South | CHNDAZSODS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Chandler West | CHNDAZWEDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Coolidge | CLDGAZMARS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Circle City | CRCYAZNMRS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Casa Grande | CSGRAZMADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Cave Creek | CVCKAZMADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Dudleyville | DDVLAZNMRS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Deer Valley | DRVYAZNODS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Eloy | ELOYAZ01RS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Florence | FLRNAZMARS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Ft. McDowell | FTMDAZMADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Rio Verde | FTMDAZNORS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Coldwater (Goodyear) | GDYRAZCWDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Gila Bend | GLBNAZMARS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Glendale | GLDLAZMADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Higley | HGLYAZMADS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Queen Creek (Higley) | HGLYAZQCDS2 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Kearny | KRNYAZMARS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Litchfield Park | LTPKAZMADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Gilbert (Mesa) | MESAAZGIDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Mesa | MESAAZMADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Mammoth | MMTHAZMARS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Maricopa | MRCPAZMARS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | New River | NWRVAZMADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Oracle | ORCLAZMARS1 | [redacted] | [redacted] | [redacted] | [redacted] |

| | | | Number of CLECs | | | |
|---|---|---|---|---|---|---|
| Area | Wire Center | CLLI Code | UNE-L | UNE-P | Resale | Facilities |
| Phoenix | Foothills | PHNXAZ81DS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Bethany West (Phoenix) | PHNXAZBWDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Cactus (Phoenix) | PHNXAZCADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Phoenix East | PHNXAZEADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Greenway (Phoenix) | PHNXAZGRDS0 | [redacted] | [redacted] | [redacted] | [redacted] |

| | | | | | | |
|---|---|---|---|---|---|---|
| Phoenix | Laveen (Phoenix) | PHNXAZLVDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Phoenix Main | PHNXAZMADS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Mid Rivers (Phoenix) | PHNXAZMRDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Maryvale (Phoenix) | PHNXAZMYDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Phoenix Northeast | PHNXAZNEDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Phoenix North | PHNXAZNODS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Phoenix Northwest | PHNXAZNWDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Pecos (Phoenix) | PHNXAZPPDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Peoria (Phoenix) | PHNXAZPRDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Phoenix Southeast | PHNXAZSEDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Phoenix South | PHNXAZSODS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Sunnyslope (Phoenix) | PHNXAZSYDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Phoenix West | PHNXAZWEDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Pinnacle Peak | PRVYAZPPDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Scottsdale Main | SCDLAZMADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Shea (Scottsdale) | SCDLAZSHDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Thunderbird (Scottsdale) | SCDLAZTHDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | San Manuel | SNMNAZMADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Superior | SPRRAZMARS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Super East | SPRSAZEADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Super Main | SPRSAZMADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Super West | SPRSAZWEDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Stanfield | STFDAZMARS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Tempe | TEMPAZMADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | McClintock (Tempe) | TEMPAZMCDS0 | [redacted] | [redacted] | [redacted] | [redacted] |

| | | | Number of CLECs | | | |
|---|---|---|---|---|---|---|
| Area | Wire Center | CLLI Code | UNE-L | UNE-P | Resale | Facilities |
| Phoenix | Tolleson | TLSNAZMADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Wickenburg | WCBGAZMARS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | White Tanks | WHTKAZMARS2 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Whitlow | WHTLAZMADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix | Wintersburg | WNBGAZ01RS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson | Coronado | CRNDAZMADS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson | Green Valley | GNVYAZMADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson | Marana | MARNAZMARS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson | Catalina (Tucson) | TCSNAZCADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson | Cortaro (Tucson) | TCSNAZCODS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson | Craycroft (Tucson) | TCSNAZCRDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson | Tucson East | TCSNAZEADS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson | Flowing Wells (Tucson) | TCSNAZFWDS0 | [redacted] | [redacted] | [redacted] | [redacted] |

| | | | | | | |
|---|---|---|---|---|---|---|
| Tucson | Tucson Main | TCSNAZMADS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson | Mt. Lemmon (Tucson) | TCSNAZMLRS2 | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson | Tucson North | TCSNAZNODS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson | Rincon (Tucson) | TCSNAZRNDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson | Tucson Southeast | TCSNAZSEDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson | Tucson South | TCSNAZSODS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson | Tucson Southwest | TCSNAZSWDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson | Tanque Verde (Tucson) | TCSNAZTVDS0 | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson | Tucson West | TCSNAZWERS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson | Vail North | VAILAZNORS1 | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson | Vail South | VAILAZSODS0 | [redacted] | [redacted] | [redacted] | [redacted] |

EXHIBIT AFF-20 Wire Center Summary by UNE Zone & Qwest Line Decline '00-'03

All figures based on line information from DLT-17 or RUCO DR2

| Requested Competitive Zone Wire Centers | WC Area | UNE Zone | Q Total Lines 12/03 | Q Line Change 12/00- 12/03 (DLT-17) Bus | Res | Q Market Share of Lines (RUCO) Bus & Res | Ave UNE & Resale CLECs | # of Bypass CLECs |
|---|---|---|---|---|---|---|---|---|
| Phoenix North | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| McClintock (Tempe) | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix Northeast | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Tempe | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Pecos (Phoenix) | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Mesa | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Cactus (Phoenix) | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix Northwest | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix West | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Glendale | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix Main | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Sunnyslope (Phoenix) | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Scottsdale Main | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix East | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix South | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Greenway (Phoenix) | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Thunderbird (Scottsdale) | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Chandler West | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Maryvale (Phoenix) | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Mid Rivers (Phoenix) | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Phoenix Southeast | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Foothills | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Super West | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Shea (Scottsdale) | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Peoria (Phoenix) | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Gilbert (Mesa) | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Chandler Main | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Deer Valley | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Bethany West (Phoenix) | Phoenix | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Ft. McDowell | Phoenix | 2 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Super Main | Phoenix | 2 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Casa Grande | Phoenix | 2 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Super East | Phoenix | 2 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Coldwater (Goodyear) | Phoenix | 2 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Cave Creek | Phoenix | 2 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Chandler South | Phoenix | 2 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Beardsley | Phoenix | 2 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Pinnacle Peak | Phoenix | 2 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Litchfield Park | Phoenix | 2 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Tolleson | Phoenix | 2 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| San Manuel | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Wintersburg | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Circle City | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Whitlow | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Wickenburg | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Mammoth | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| New River | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Superior | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Eloy | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Kearny | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Oracle | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Gila Bend | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Coolidge | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Florence | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Stanfield | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Dudleyville | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Laveen (Phoenix) | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Buckeye | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| White Tanks | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Higley | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Maricopa | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Rio Verde | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Queen Creek (Higley) | Phoenix | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson Main | Tucson | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson East | Tucson | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Rincon (Tucson) | Tucson | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Craycroft (Tucson) | Tucson | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson South | Tucson | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Catalina (Tucson) | Tucson | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson North | Tucson | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Flowing Wells (Tucson) | Tucson | 1 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Tanque Verde (Tucson) | Tucson | 2 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson West | Tucson | 2 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Green Valley | Tucson | 2 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Cortaro (Tucson) | Tucson | 2 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Coronado | Tucson | 2 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson Southeast | Tucson | 2 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Mt. Lemmon (Tucson) | Tucson | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Tucson Southwest | Tucson | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Marana | Tucson | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Vail North | Tucson | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Vail South | Tucson | 3 | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |

EXHIBIT AFF-21 Phoenix Main Wire Center

| CLEC_NAME | Estimated CLEC - Owned Lines (Dec 2003) | UNE-L | UNE-P | Resale | Totals |
|---|---|---|---|---|---|
| ACN Communications Services Inc | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Allegiance Telecom Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Arizona Dial Tone | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| AT&T | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| AT&T Communications, Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| AT&T Local Service (fka TCG) | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Budget Phone Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| CapRock Telecommunications Corp. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Comm South Companies Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Cox Telcom L.L.C. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| DPI Teleconnect L.L.C. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Electric Lightwave, Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Ernest Communications Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Eschelon Telecom Inc | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Excel Telecommunications Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Global Crossing Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Global Crossing Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Granite Telecommunications LLC | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Intermedia Communications Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Level 3 Communications LLC | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| MCI | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| MCImetro Access Transmission Services LLC | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| McLeod | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| McLeodUSA | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| McLeodUSA Telecommunications Services Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Mountain Telecommunications | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| North County Communications | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| NOS Communications Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Pac-West Telecomm Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Preferred Carrier Services Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Quality Telephone | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| QuantumShift Communications Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Regal Telephone Company | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| SBC Telecom Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |

| CLEC_NAME | Estimated CLEC - Owned Lines (Dec 2003) | UNE-L | UNE-P | Resale | Totals |
|---|---|---|---|---|---|
| Sprint Communications Company L.P. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Tel West Communications LLC | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Time Warner Telecom Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| VarTec Telecom Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Winstar Communications LLC | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| XO Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Z-Tel Communications Inc. | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Total | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |

| | | | | | |
|---|---|---|---|---|---|
| Qwest | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |

# SMITH

**BEFORE THE ARIZONA CORPORATION COMMISSION**

MARC SPITZER
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

| | | |
|---|---|---|
| IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN | ) | DOCKET NO. T-01051B-03-0454 |
| IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS | ) | DOCKET NO. T-00000D-00-0672 |

DIRECT

TESTIMONY

OF

DEL SMITH

UTILITIES ENGINEER SUPERVISOR

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

NOVEMBER 18, 2004

## TABLE OF CONTENTS



## EXHIBITS

# EXECUTIVE SUMMARY
# QWEST CORPORATION
# DOCKET NOS. T-01051B-03-0454 & T-00000D-00-0672

My Testimony regarding Qwest's service quality is organized into three sections and discusses Qwest performance during the initial term of the Price Cap Plan and makes certain recommendations intended to benefit customers by providing incentives for Qwest to maintain, if not improve, the levels of performance it has attained. The first section provides an overview of the history of Qwest's Service Quality Plan Tariff. Section two discusses Section 5 of the Price Cap Plan Settlement Agreement which addresses service quality and performance penalties included in the Service Quality Plan Tariff. In the third section, I address additional service quality performance measurements that provide insight as to how Qwest has performed during the initial term of the Price Cap Plan.

Staff has reservations concerning Qwest's ongoing performance after May 2003 for Residence Office Access due to the number of months a penalty has been incurred. While the trend for Repair Office Access shows a negative trend, results remain well above a level where penalties would be accessed. When the five categories (Held Orders, Out-of-Service Repair, Residence Office Access, Business Office Access and Repair Office Access) are viewed collectively, Staff believes that, from a penalty perspective, a conclusion can be reached that Qwest service quality for these categories has not diminished, and overall has improved, during the initial term of the Price Cap Plan. In addition, Staff believes that its review of performance data relating to billing credits, fee waivers, customer trouble reports and Commission complaints also indicates that Qwest service quality for these categories has not diminished, and overall has also improved, during the initial term of the Price Cap Plan.

Staff recommends that the current one-time credit penalty of $2.00 for each residence and business access line be continued and that conforming language be added to Qwest's Service Quality Plan Tariff. Second, Staff recommends certain technical adjustments to the penalty ranges for Residence Office Access, Business Office Access and Repair Office Access. Third, Staff recommends that a total company customer trouble objective be established and included in the Service Quality Plan Tariff. Finally, Staff recommends that all provisions of the Service Quality Plan Tariff not modified by recommendations in this Testimony be included in any renewal of the Price Cap Plan by the Commission.

**Introduction**

**Q. Please state your name and business address.**

A. My name is Del Smith. My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

**Q. By whom are you employed and what is your position?**

A. I am employed by the Arizona Corporation Commission (the "Commission") in its Utilities Division. My title is Utilities Engineer Supervisor.

**Q. Briefly describe your responsibilities as a Utilities Engineer Supervisor.**

A. In my capacity as a Utilities Engineer Supervisor, I provide recommendations and technical assistance to the Commissioners and to other staff members on matters that come before the Commission involving Qwest Corporation ("Qwest") and other telecommunications service providers operating in the State. In addition, I am responsible for supervising other staff members who work in the Engineering Section of the Utilities Division.

**Q. Please describe your educational background and professional experience.**

A. I graduated from Arizona State University in 1976 with a Bachelor of Science Degree in Engineering Technology. Prior to joining the Commission in 1985 as a Utilities Consultant, I had worked for a telephone operating company for twelve years where I held positions in network planning and design. Since joining the Commission, I have worked on hundreds of issues that have come before this Commission including Qwest's last rate application which resulted in the initial Qwest Price Cap Plan.

**Q. What is the scope of your testimony in this case?**

A. I will review Qwest's retail service quality during the initial term of the Price Cap Plan.

**Q. Have you reviewed the Notice of Filing Renewed Price Regulation Plan submitted by Qwest in this case?**

A. Yes.

**Summary of Testimony and Recommendations**

**Q. Briefly discuss how your Testimony addressing service quality is organized.**

A. My Testimony regarding Qwest's service quality is organized into three sections. The first section provides an overview of the history of Qwest's Service Quality Plan Tariff. The second Section of my testimony discusses Section 5 of the Price Cap Plan Settlement Agreement which addresses service quality and performance penalties included in the Service Quality Plan Tariff. In the third section, I address additional service quality performance measurements that provide insight as to how Qwest has performed during the initial term of the Price Cap Plan.

**Q. Please summarize your recommendations as they pertain to service quality.**

A. First, Staff recommends that the current one-time credit penalty of $2.00 for each residence and business access line be continued and that conforming language be added to Qwest's Service Quality Plan Tariff. Second, Staff recommends certain technical adjustments to the penalty ranges for Residence Office Access, Business Office Access and Repair Office Access. Third, Staff recommends that a total company customer trouble objective be established and included in the Service Quality Plan Tariff. Finally, Staff recommends that all provisions of the Service Quality Plan Tariff not modified by recommendations in this Testimony be included in any renewal of the Price Cap Plan by the Commission.

**History of Qwest's Service Quality Plan Tariff**

**Q. What is the purpose of Qwest's Service Quality Plan Tariff?**

A. In 1995, the Commission approved the Service Quality Plan Tariff in Decision Nos. 59147 and 59421. The tariff established several quality of service objectives for U S West (n/k/a Qwest), to meet. U S West telephone service was problematic and the Tariff was designed to improve the quality of service received by customers of the Company. The Tariff lists definitions to be used, and sets out records requirements, complaints and appeals procedures, billing requirements, construction standards, network standards and service requirements. The Tariff specifies penalties, through customer credits and fee waivers, which will be imposed if the requirements of the Tariff are not met. Additionally, the Tariff specifies penalties that will be paid to the State Treasury should certain service quality performance criteria not be met.

**Q. Please briefly describe Section 2.6 of Qwest's Service Quality Plan Tariff.**

A. Section 2.6 of Qwest's Service Quality Plan Tariff defines five (5) performance categories and their respective performance metrics and penalty levels. The performance categories are: 1) Held Orders, 2) Out-of-Service Repair, 3) Residence Office Access, 4) Business Office Access and 5) Repair Office Access.

**Q. Please provide a brief explanation of the five (5) performance categories.**

A. A held order is an establishment for service which is not filled by the due date because of the inability of the company to supply service. In Section 2.6, total held orders are tracked as a percentage of working access lines.

Qwest is required to clear 85 percent of all out-of-service trouble reports within 24 hours per its Service Quality Plan Tariff. An out-of-service trouble report is where the customer's service quality has deteriorated to such an extent that the customer cannot originate or receive calls. Section 2.6 tracks the percent of out-of-service trouble reports cleared in less than 24 hours.

Calls directed to published telephone numbers for service repair or the business offices of the Company shall be answered by an operator within 20 seconds for 80 percent of all such calls. Section 2.6 tracks the percent of calls answered within 20 seconds to the Residence Office, the Business Office and the Repair Office.[1]

**Q. Please describe the revision that was made to the tariff.**

A. Prior to the initial term of the Price Cap Plan, the Service Quality Plan Tariff was revised to provide for the doubling of some penalties if certain service quality performance standards were not met for two consecutive years. This provision was added when the Commission approved the merger of U S West and Qwest. Specifics are contained in Section 2.6.1.E of the Service Quality Plan Tariff.

**Service Quality and Section 5 of the Price Cap Plan Settlement Agreement**

**Q. Does the Settlement Agreement in Qwest's last general rate case address service quality and Qwest's Service Quality Plan Tariff?**

A. Yes. Section 5 of the Settlement Agreement addresses service quality. In particular, this section provides for additional customer credits should certain performance criteria not be met. The section also documents a commitment by Qwest to implement additional employee training programs with respect to new technologies and service improvements.

[1] For further explanation of each of the five performance categories and what is being measured refer to Sections 2.1, 2.5.5.B.3, 2.5.6.B and 2.6.1.F through J of Qwest's Service Quality Plan Tariff.

**Q. Did the Price Cap Plan Settlement Agreement establish an additional new penalty criteria and what was the purpose of adding the additional penalty criteria?**

A. Yes. Section 5 of the Settlement Agreement contains a provision that implements additional one-time credits of $2.00 for each residence and business access line due to having paid Service Quality Plan penalty payments in two or more categories in one calendar year. The primary intent of this new criteria was to provide a benefit to customers by incenting Qwest to consistently maintain its service quality during the initial term of the Price Cap Plan.

**Q. In terms of penalty payments, what has Qwest's performance been in the calendar years in which the Price Cap Plan has been in effect?**

A. Annual Service Quality Plan penalty payments paid by Qwest are listed in the following table. Calendar year 2000, which is prior to the start of the Price Cap Plan, is included for reference and calendar year 2004 is through June 30th.

| Category | 2000 | 2001 | 2002 | 2003 | 2004 |
|---|---|---|---|---|---|
| Held Order | 365,000 | 0 | 0 | 0 | 0 |
| Out-of-Service | 153,000 | 0 | 0 | 0 | 0 |
| Residence Office Access | 0 | 454,000 | 0 | 153,000 | 121,000 |
| Business Office Access | 0 | 0 | 0 | 0 | 0 |
| Repair Office Access | 0 | 0 | 0 | 0 | 0 |
| Total | 518,000 | 454,000 | 0 | 153,000 | 121,000 |

**Q. Was Qwest required to implement additional one-time credits of $2.00 for each residence and business access line due to having paid Service Quality Plan penalty payments in two or more categories in one calendar year?**

A. No. As the above table illustrates, Qwest has been subject to a Service Quality Plan penalty for no more than one category during calendar years 2001, 2002, and 2003.

**Q. Does Staff recommend that this element of the Price Cap Plan remain in any renewal of the Price Cap Plan?**

A. Yes. While Qwest did not have to implement the additional one-time credits during the initial term of the Price Cap Plan, Staff believes this requirement provides a major customer service quality benefit by providing a significant incentive to Qwest to maintain its performance in these service quality measures at a higher level than might otherwise occur should this requirement not be in place.

**Q. Does Staff recommend that language addressing the one-time credit be added to Qwest's Service Quality Plan Tariff?**

A. Yes. Information about the credit would then be available in the tariff which is where the public and other interested parties would look for such information. Section 2.6 of the Tariff already contains details of the ranges and penalty and offset amounts. Thus adding language addressing the one-time credit would be consistent with what is already contained in the Tariff.

**Q. From an individual metric perspective, what has the trend been for each of the five Service Quality Plan categories during the Price Cap Plan?**

A. Exhibits S-1 through S-5, which were provided by Qwest in response to data request STAFF 11.1 as Non-Confidential Attachment A, illustrate Qwest's performance on a monthly basis for each of the five categories from January 2000 through May 2004.

Held Order quantities were decreasing prior to the start on the Price Cap Plan and that trend has continued. Current results for Held Orders demonstrate a significant improvement.

Out-of-Service Repair performance has generally remained in, or above, the no penalty range (i.e. above 80.01 percent cleared within 24 hours). However, results in 2003 were more variable and results were in the penalty range for three of the twelve months.

Residence Office Access performance experienced a decline after the start of the Price Cap Plan before experiencing a significant improvement. Residence Office Access has generally remained in, or above the no penalty range (i.e. above 70.01 percent of calls answered within 20 seconds). However, results in 2003 were more variable and results were in the penalty range for four of the twelve months. Year-to-date 2004 results have been similar with three months out of six being in the penalty range.

Business Office Access has been less volatile than Residence Office Access (performance ranges are the same). However, there was a substantial decline in performance for approximately three months in late 2003 and early 2004.

Repair Office Access has been in a trend of slightly decreasing performance (the same performance ranges as Residence and Business Access are applicable). However, performance has remained in, or above, the no penalty range during the entire time frame shown.

**Q. What conclusion does Staff make in regards to Qwest performance for these categories for the period of time the Price Cap Plan has been in effect?**

A. Staff has reservations concerning Qwest's ongoing performance after May 2003 for Residence Office Access due to the number of months a penalty has been incurred. While the trend for Repair Office Access shows a negative trend, results remain well above a level where penalties would be accessed. Staff would like to see further improvement in this area. When the five categories are viewed collectively, Staff concludes that Qwest service quality has not diminished, and overall has improved, during the initial term of the Price Cap Plan.

**Q. Based upon Staff's review of the performance data, does Staff have a recommendation regarding penalty and offset ranges contained in Section 2.6 of Qwest's Service Quality Plan Tariff?**

A. Yes. It is Staff's opinion that Qwest's customers would be benefited by incenting the Company to maintain the performance improvements it achieved prior to and during the initial term of the Price Cap Plan. Staff's recommendation would make two adjustments to the penalty and offset ranges for Residence Office, Business Office and Repair Office access (contained in Tariff sections 2.6.1 H, I and J). The first adjustment would split the offset range into two ranges with differing offset amounts. The second would decrease the width of the no penalty range by five (5) percent which would shift the lower three ranges upward by five (5) percent. Staff's recommendation is illustrated in the following table.

| Current Range | Current Penalty/Offset | Recommended Range | Recommended Penalty/Offset |
|---|---|---|---|
| 85.01% - 100.00% | $4,000/day offset | 90.01% - 100.00% | $4,000/day offset |
| | | 85.01% - 90.00% | $2,000/day offset |
| 70.01% - 85.00% | No penalty | 75.01% - 85.00% | No penalty |
| 56.01% - 70.00% | $1,000/day penalty | 61.01% - 75.00% | $1,000/day penalty |
| 32.01% - 56.00% | $2,000/day penalty | 37.01% - 61.00% | $2,000/day penalty |
| 0% - 32.00% | $4,000/day penalty | 0% - 37.00% | $4,000/day penalty |

**Q. How does Staff believe Qwest customers would be benefited by Staff recommended change to the penalty and offset ranges?**

A. First, Section 2.5.5.B.3 of the Service Quality Plan Tariff states an objective for these three measurements which is that eighty (80) percent of all such calls shall be answered within twenty (20) seconds. Thus, the current range for no penalty is lop-sided with 2/3 of the no penalty range being below objective. Staff's recommendation narrows and balances the no penalty range around the objective which should encourage Qwest to maintain a higher performance level that more closely meets the objective in order to not incur a penalty.

Second, shifting the lower ranges upward appropriately penalizes Qwest over a broader range for poor performance and has the potential for increased penalties should low levels of performance occur. This risk can be avoided by the Company by maintaining high levels of service which, in turn, benefits customers.

Third, splitting the offset range into two components minimizes the potential for one good month offsetting as many as four months of poorer performance. For example, currently one month with performance between 85.01 percent and 90.00 percent would offset four months with performance in a range of 56.01 percent to 70.00 percent. Staff's recommendation would reduce this example to two months of 61.01 percent to 75.00 percent performance. While the Company could still receive the highest offset amount, it could only do so for results over 90.01 percent. Thus, the Company should be incented to maintain performance at a high level and customers would benefit.

Finally, Qwest was performing poorly when the original ranges were established and the ranges were set in a manner that would encourage Qwest to improve its service quality. Now that Qwest's service results have improved, it is appropriate to make adjustments that would incent Qwest to maintain its higher level of performance.

**Q. Did Staff determine what the impact of its recommendation would have been had its recommended change been in effect during the calendar years the initial term of the Price Cap Plan was in place?**

A. Yes. The following table summarizes what Qwest penalties would have been had Staff's recommendation been implemented during the calendar years overlapped by the initial term of the Price Cap Plan. As can be seen, nominal increases would have occurred in calendar years 2001 and 2003 (calendar year 2000 is prior to the initial term of the Price Cap Plan and calendar year 2004 is though June 30th).

| | 2000 | 2001 | 2002 | 2003 | 2004 |
|---|---|---|---|---|---|
| Residence Office | | | | | |
| - Current | 0 | 454,000 | 0 | 153,000 | 121,000 |
| - Recommended | 33,000 | 544,000 | 0 | 244,000 | 121,000 |
| - Change | +33,000 | +90,000 | 0 | +91,000 | 0 |
| | | | | | |
| Business Office | | | | | |
| - Current | 0 | 0 | 0 | 0 | 0 |
| - Recommended | 0 | 0 | 0 | 0 | 0 |
| - Change | 0 | 0 | 0 | 0 | 0 |
| | | | | | |
| Repair Office | | | | | |
| - Current | 0 | 0 | 0 | 0 | 0 |
| - Recommended | 0 | 0 | 0 | 0 | 0 |
| - Change | 0 | 0 | 0 | 0 | 0 |

**Q. Does Staff have a similar recommendation to make for the Out-of-Service and Held Order performance categories?**

A. No, not at this time. Qwest performance for these two categories suggests that the current ranges and associates penalties and offsets are sufficient to encourage continued good performance by the Company. Out-of-Service results have been on an improving trend since 2000 and, for the most part, results for individual months have been above the objective of eighty-five (85) percent. Held Order results demonstrate significant improvement; particularly since January 2003. However, should Qwest results for either of these two categories begin to significantly deteriorate at some point in the future, it may be appropriate to recommend alternatives to the current performance ranges and penalties/offsets for these categories.

**Q. Section 5 of the Settlement Agreement also committed Qwest to implementing training programs for its "Arizona employees with respect to new technologies and service improvements". Did Qwest establish training programs to address this?**

A. Yes. Qwest worked cooperatively the CWA to establish training programs for Network Technicians and Central Office Technicians. The programs established for Network Technicians consist of two phases, each one week in duration. A total of five training laboratories were constructed at both rural and urban locations in Qwest service territory.

For Central Office Technicians, certification training in two digital switch technologies was approved by the joint Qwest/CWA board. This training is above and beyond normal training for this employee classification.

**Other Service Quality Indicators**

**Q. In addition to the service quality categories already discussed, did Staff utilize other performance data to evaluate Qwest service quality and, if so, what were theses measures?**

A. Yes. Qwest provides Commission Staff each quarter a Service Quality Plan Report that shows performance on other measures in addition to those already discussed. Specifically, for the years overlapped by the initial term of the Price Cap Plan, Staff reviewed Qwest performance in regards to billing credits, fee waivers and customer trouble reports.

**Q. What are billing credits and what was Staff's conclusion after reviewing the data that Qwest reported for the years 2000, 2001, 2002, 2003 and 2004 (through June 30$^{th}$)?**

A. Billing credits are adjustments automatically made by Qwest to a customer's bill for performance issues such as extended service interruptions, missed service calls or initial basic local service that is not provided within thirty (30) days. These credits would also include Fee items such as vouchers given to a customer by Qwest for cellular service or voice messaging or paging service credits where basic local service has not been provided within thirty (30) days. In 2000, these types of credits provided to customers were in excess of [redacted] dollars. The level of credits paid since that time has decreased each year, in 2002 credits provided to customers were just under [redacted] dollars and in 2003 these credits declined to approximately [redacted] dollars. Based upon Qwest performance through June of 2004, Staff anticipates that the level of billing credits for 2004 will be less than [redacted] dollars.

**Q. What are customer trouble reports and what was Staff's conclusion after reviewing what Qwest reported for the years 2000, 2001, 2002, 2003 and 2004 (through June 30$^{th}$)?**

A. Customer trouble reports measure trouble reported with Qwest's network as reported by the customer. This measure is reported on a reports per 100 access line basis and excludes reports for services of another provider or when access to a customer premises is not available. Staff observed that the trend for trouble reports has been improving; i.e. the number of reports over the time frame reviewed has been decreasing. For example, the total trouble report rate per 100 lines in the fourth quarter of 2000 averaged [redacted]. In the following three years for the same quarter this trouble rate declined to [redacted] (2001), [redacted] (2002) going back up slightly to [redacted] (2003). As might be expected, as Qwest has improved it service quality, the trend line has flattened out to a more consistent performance level since early 2002.

**Q. In regards to customer trouble reports, did Staff review data that would compare Qwest performance between its urban service areas (defined as Phoenix and Tucson metro) and rural service areas and, if so, what was Staff's conclusion?**

A. Yes. Staff reviewed Qwest's response, which was provided as Confidential Attachment A, to Staff data request STAFF 11.13. Over the four and a half year time frame examined, Staff observed there have been months where rural results were equal to or better than those reported for urban areas. For those months where rural results were higher than urban, the difference in reported trouble was less than 0.2 percent approximately 73 percent of the time and less than 0.3 percent approximately 86 percent of the time. Given that difference in monthly average results between urban and rural areas was relatively small, and that the average monthly results for both urban and rural areas were significantly less than the maximum of eight (8) reports per month per wire center averaged over a three-month period set forth in the Service Quality Plan Tariff, it appears that, from a trouble report perspective, comparable service quality is being provided to urban and rural areas.

**Q. After its review of Qwest customer trouble reports, does Staff have a recommendation regarding performance objectives for this measure and, if so, what is it?**

A. Yes. Section 2.5.6.A of the Service Quality Plan Tariff sets forth a maximum trouble report rate on an individual wire center basis. At this time Staff, does not propose a change to the wire center maximum. However, the section is silent in regards to a total company standard. Based upon Qwest's performance for the years 2000, 2001, 2002, 2003 and 2004 (through June 30th), Staff would recommend that the Tariff be revised to establish a total company maximum objective of no more than 3.0 trouble reports per 100 access lines in any month averaged over all wire centers. Staff believes the objective is reasonable as Qwest has not exceeded this level in any month since the inception of the Price Cap Plan. Further, establishing such an objective would provide incentive to the Company to maintain the higher service levels it has achieved and thus provide ongoing benefit to customers.

Q. **Is the number of complaints concerning Qwest received by the Consumer Services Section of the Commission also indicative of improving levels of service quality?**

A. Yes. A review of the Commission's Consumer Services Database shows that a declining number of complaints were received during the time period of January 1, 2000 through June 30, 2004. These quantities are listed in the following table.

| | 2000 | 2001 | 2002 | 2003 | 2004 |
|---|---|---|---|---|---|
| Complaints | 3562 | 1850 | 1313 | 607 | 254 |

Staff also reviewed Commission complaint data provided by Qwest in its quarterly Service Quality Plan Tariff reporting. Staff observed that during period of January 2000 through June 2004, Commission complaints decreased each month from levels for the same month the prior year in all but five months. In two of these five instances, the number of Commission complaints had remained the same.

Q. **The Commission's Consumer Services Database shows a significant decline in the Qwest complaints received. What would you attribute this decline to?**

A. Qwest made some significant strides in improving its service quality in the categories of held orders and out-of-service repair during 2000, 2001 and 2002. The decline in complaints during 2003 and 2004 is due in part to changes in how complaints were being categorized. A significant number of complaints were being categorized as consumer inquiries and were not included in the complaint quantities provided for this period. Thus the level of complaints would be higher if the consumer inquiries were included. However, even with an adjustment, Staff believes that the trend in Commission complaints would still have declined significantly during 2003 and 2004. Complaint levels have improved more recently because Qwest has been doing a better job of handling complaints so that fewer complaints are being received by the Commission.

**Conclusions and Recommendations**

**Q. In summary, what are Staff's overall conclusions regarding Qwest service quality during the initial term of the Price Cap Plan?**

A. As previously stated, Staff has reservations concerning Qwest's ongoing performance after May 2003 for Residence Office Access due to the number of months a penalty has been incurred. While the trend for Repair Office Access shows a negative trend, results remain well above a level where penalties would be accessed. Staff would like to see further improvement in this area. Staff also reviewed performance data relating to billing credits, fee waivers, customer trouble reports and Commission complaints. Reviewing all of the performance data collectively, Staff concludes that Qwest service quality has not diminished, and overall has improved, during the initial term of the Price Cap Plan.

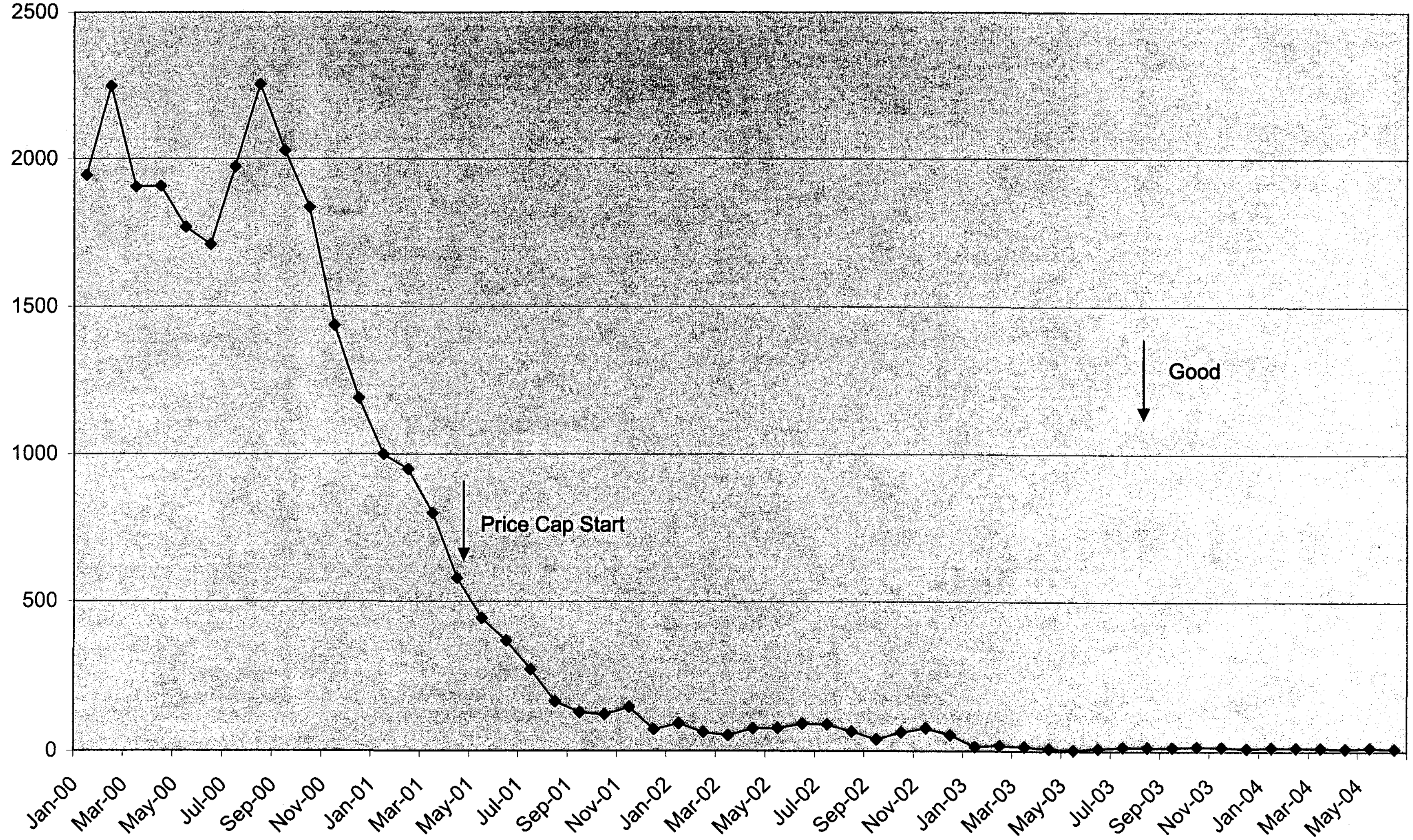
**Q. Should the Commission approve a renewal of the Price Cap Plan, is it Staff's opinion that the Commission should include the recommendations made in this Testimony in such a Decision?**

A. Yes. Furthermore, Staff recommends that all provisions of the Service Quality Plan Tariff not modified by recommendations in this Testimony be retained.

**Q. Does this conclude your Direct Testimony?**

A. Yes, it does.

# Held Orders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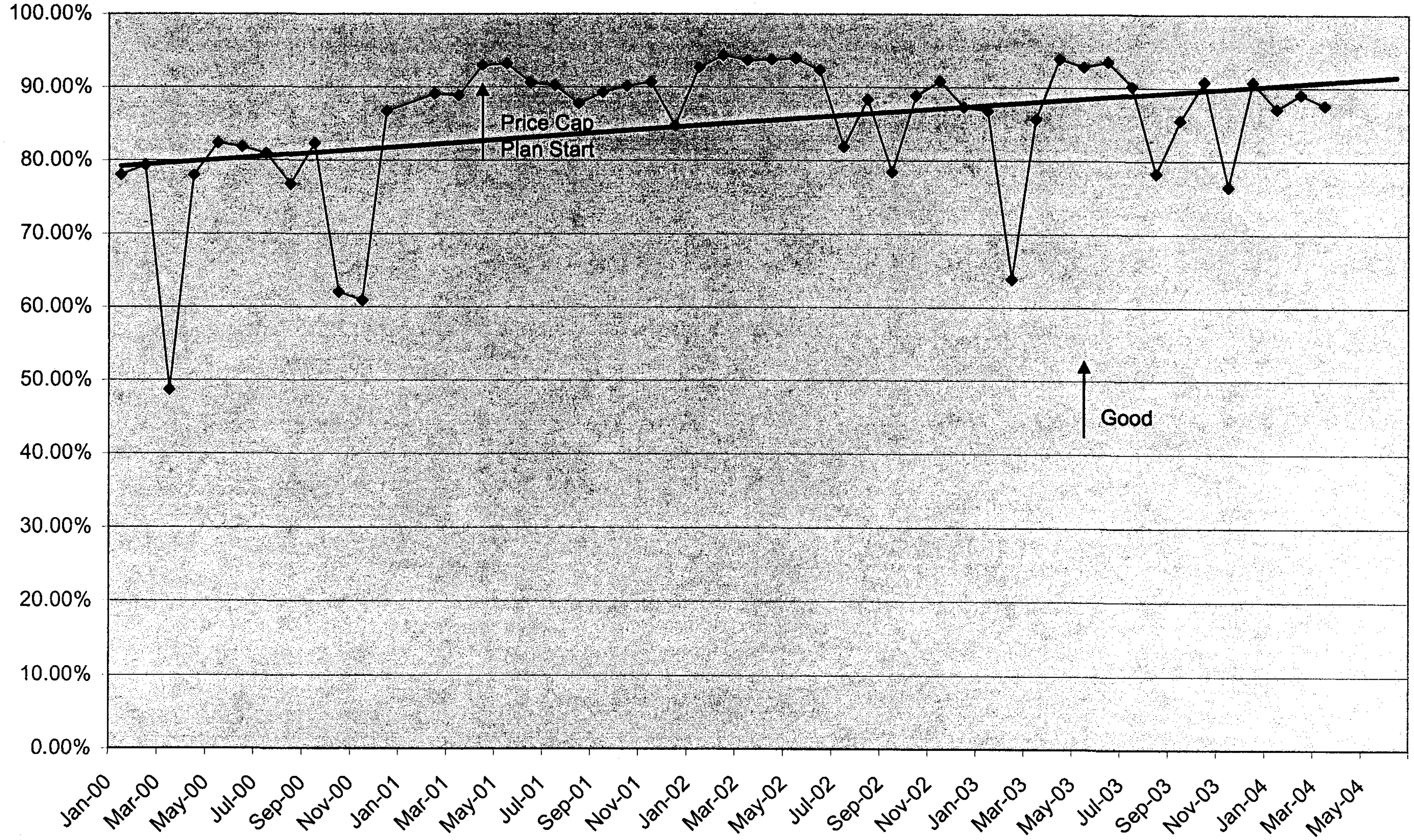
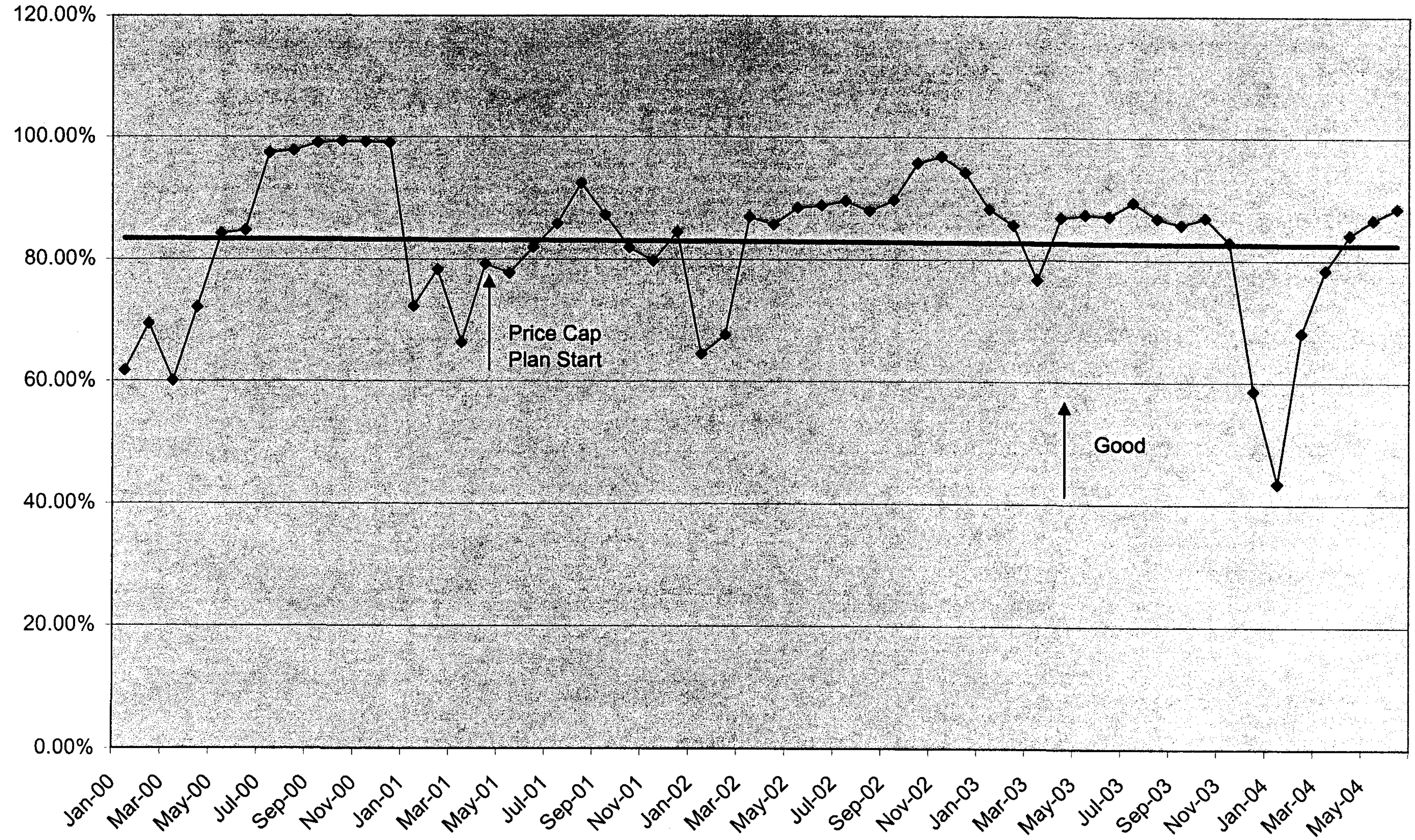
Mar-04
May-04

Arizona
Docket No. T-01051B-03-0454 et al.
STF 11-1
Non-Confidential Attachment A
Exhibit DS-2

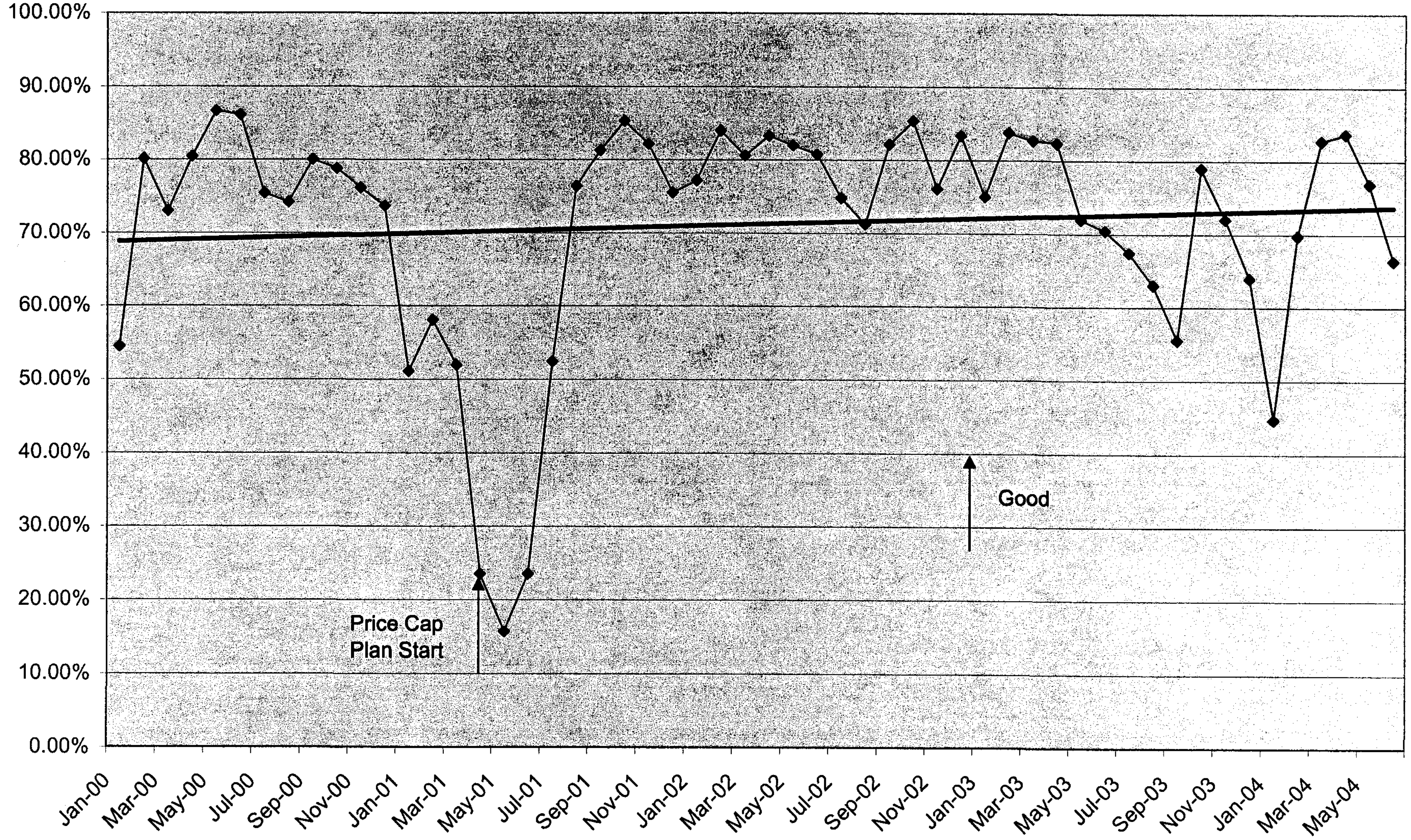
# Out of Service



# Business Office Access

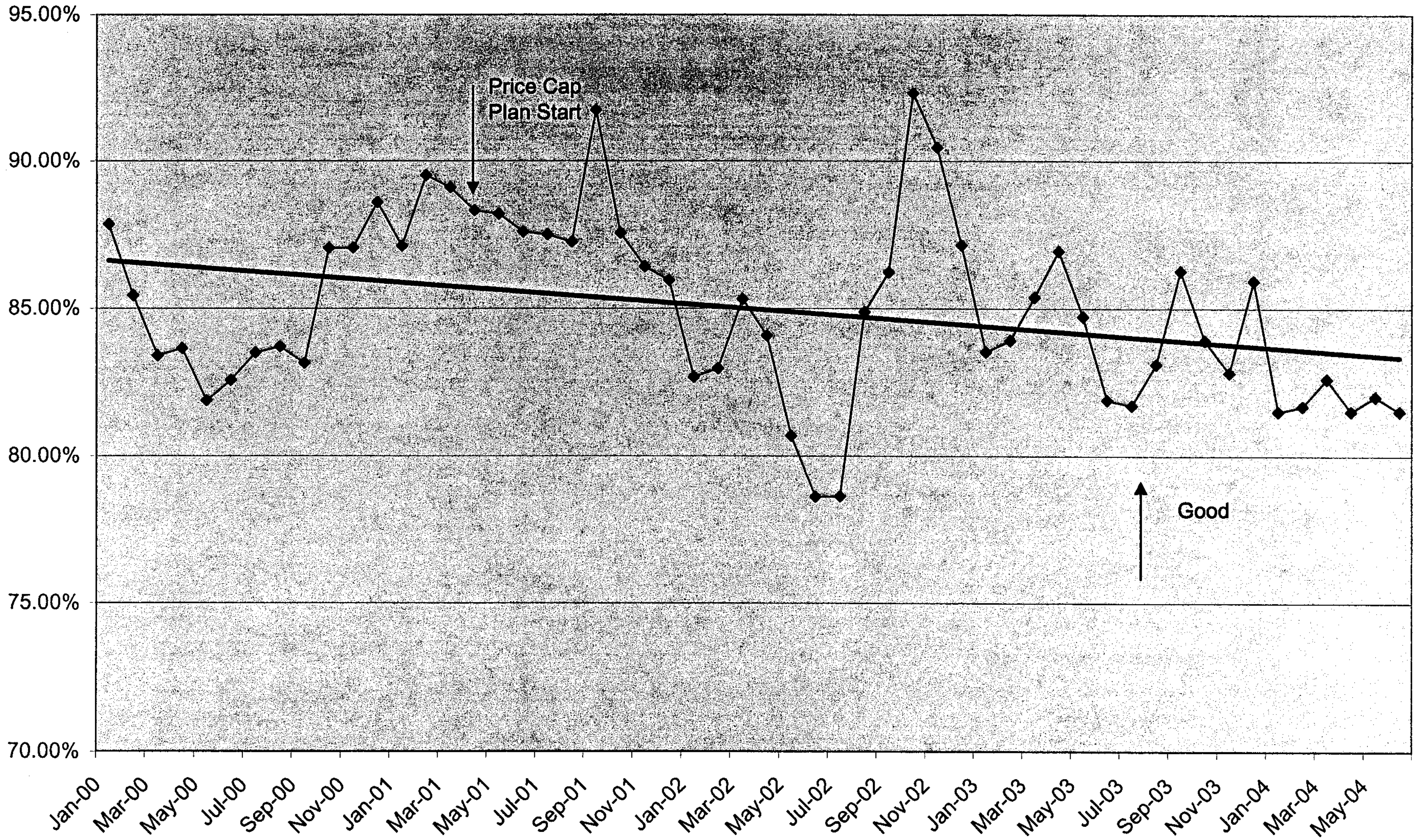


# Residence Office Access



Arizona
Docket No. T-01051B-03-0454 et al.
STF 11-1
Non-Confidential Attachment A
Exhibit DS-5

# Repair Office Access



# REIKER

**BEFORE THE ARIZONA CORPORATION COMMISSION**

MARC SPITZER
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN MAYES
Commissioner

| | | |
|---|---|---|
| IN THE MATTER OF QWEST CORPORATION'S FILING AMENDED RENEWED PRICE REGULATION PLAN. | ) ) ) ) | DOCKET NO. T-01051B-03-0454 |
| IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS | ) ) ) ) | DOCKET NO. T-00000D-00-0672 |

DIRECT

TESTIMONY

OF

JOEL M. REIKER

SENIOR PUBLIC UTILITIES ANALYST

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

NOVEMBER 18, 2004

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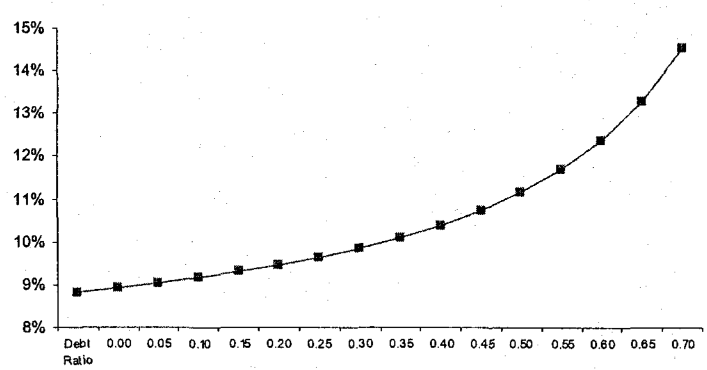
## SCHEDULES

## Executive Summary

The direct testimony of Staff witness Joel M. Reiker addresses the following issues:

Cost of Equity – Staff recommends the Commission adopt a 14.6 percent return on equity ("ROE") for Qwest. Staff bases its ROE recommendation on its discounted cash flow ("DCF") and capital asset pricing model ("CAPM") analyses. Staff's recommendation is based on cost of equity estimates ranging from 9.5 percent to 12.0 percent, with a capital structure/financial risk adjuster of +3.7%. Staff's ROE recommendation is dependent upon the capital structure adopted by the Commission for Qwest in this proceeding. Because the cost of equity increases with the use of debt, and Qwest has a higher debt ratio than other comparable telecommunications services companies on average, Qwest has a higher cost of equity than those companies. The following chart shows Staff's estimate of the current relationship between Qwest's cost of equity and its debt ratio:

**Chart 3: Qwest's Cost of Equity & Leverage**




Staff's ROE recommendation assumes the Commission will adopt a capital structure consisting of approximately 75 percent debt.

Comment on the Direct Testimony of Company Witness Peter C. Cummings - The Commission should reject Mr. Cummings' proposed ROE of 21.4 percent for the following reasons:

> Mr. Cummings's capital structure/financial risk adjustment should be rejected because Mr. Cummings fails to "de-adjust" his beta estimates before unlevering and relevering them, and he uses the market value of equity to unlever beta, but uses a book value of equity to relever beta, creating a mismatch. After correcting these errors in Mr. Cummings' analysis and giving equal weight to his telco DCF cost of equity estimate, Mr. Cummings analysis supports a cost of equity/authorized ROE for Qwest of 14.3 percent, not 21.4 percent.

## INTRODUCTION

**Q. Please state your name, occupation, and business address.**

A. My name is Joel M. Reiker. I am a Senior Regulatory Analyst employed by the Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

**Q. Briefly describe your responsibilities as a Senior Regulatory Analyst.**

A. In my capacity as a Senior Regulatory Analyst, I perform studies to estimate the cost of capital for utilities that are seeking rate relief. I also provide recommendations to the Commission on mergers, acquisitions, financings, and sales of assets, and I have occasionally acted as arbitrator in disputes brought before the Utilities Division.

**Q. Please describe your educational background and professional experience.**

A. In 1998, I graduated cum laude from Arizona State University, receiving a Bachelor of Science degree in Global Business with a specialization in finance. My course of studies included classes in corporate and international finance, investments, accounting, statistics, and economics. I began employment as a Staff rate analyst in 1999. Since that time, I have attended various classes on general regulatory and business issues, including the cost of capital and the use of energy derivatives. In 2004, I attended the National Association of Regulatory Utility Commissioners and the Institute of Public Utilities' Annual Regulatory Studies Program at Michigan State University.

**Q. What is the scope of your testimony in this case?**

A. I provide Staff's recommended rate of return on common equity (ROE) in this case. Staff's recommended ROE is an estimate of Qwest Corporation's ("Qwest") cost of equity.

## SUMMARY OF TESTIMONY AND RECOMMENDATIONS

**Q. Briefly summarize how Staff's cost of equity testimony is organized.**

A. Staff's cost of equity testimony is organized into four sections. Section I discusses risk and presents Staff's cost of equity capital analysis that uses the discounted cash flow ("DCF") model and the capital asset pricing model ("CAPM"). Section II presents Staff's final cost of equity estimates and discusses the effect of Qwest's capital structure on its cost of equity. Section III presents Staff's return on equity ("ROE") recommendation. Finally, Staff's comments on the Company's proposed ROE are presented in section IV.

**Q. Have you prepared any exhibits to your testimony?**

A. Yes. I prepared twenty-four schedules (JR-1 to JR-24) that support Staff's cost of equity analysis.

**Q. What ROE Does Staff recommend?**

A. Staff recommends a 14.6 percent ROE.

**Q. Does Staff's ROE recommendation depend on the capital structure that is adopted?**

A. Yes. As Staff explains later in this testimony, the cost of equity decreases as leverage (the percentage of debt in a capital structure) decreases. Therefore, Staff's recommended ROE is *only* valid if the Commission adopts Staff's recommended capital structure of approximately 75 percent debt and 25 percent equity.

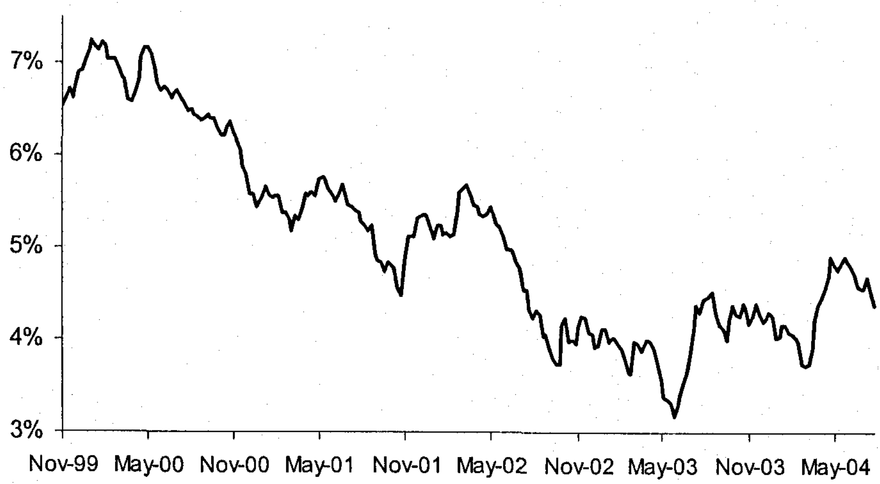
## I. THE COST OF EQUITY

### Comment on Capital Costs in General

**Q. What has been the general trend of capital costs in recent years?**

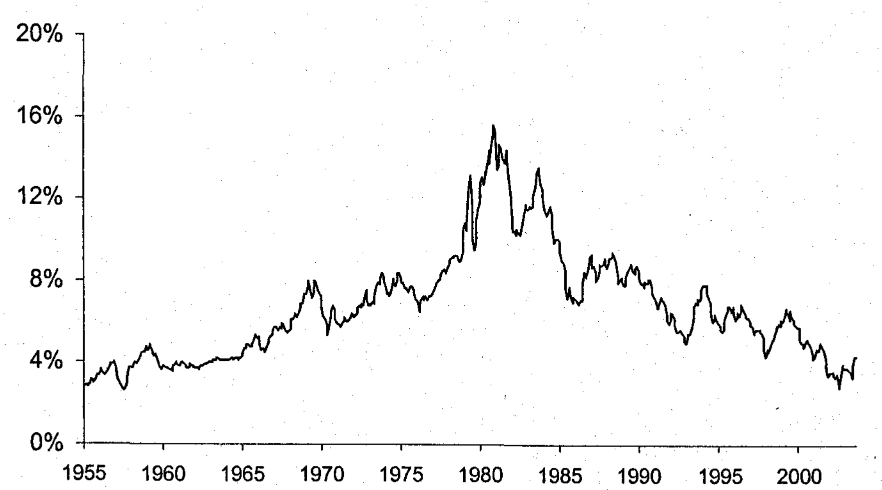
A. Interest rates have declined in recent years. Chart 1 graphs intermediate-term U.S. Treasury rates from November 1999 to August 2004:

**Chart 1: Average Yield on 5-, 7-, & 10-Year Treasuries**




The following graph puts interest rates and capital costs in general, into historical perspective. Interest rates have declined significantly in the past twenty years and are currently at levels comparable to the 1950's and '60's.

**Chart 2: History of 5- and 10-Year Treasury Yields**



According to the capital asset pricing model, the cost of equity moves in the same direction as interest rates. Chart 2 suggests that capital costs, including the cost of equity, are quite low compared to recent history.

**Q. What is the effect of recently passed tax legislation on investors' required return on stocks?**

A. The Jobs and Growth Tax Relief Reconciliation Act of 2003, which was signed on May 28, 2003, reduced the income tax rates on both capital gains and common stock dividends, lowering required pre-tax stock returns.

**Q. What have historical returns been for average risk securities?**

A. Wharton School finance professor Jeremy Siegel published his findings that the average compound and arithmetic annual returns on U.S. equities have been 8.3 percent and 9.7 percent, respectively, using 199 years of data from 1802 through 2001.[1]

One should keep in mind that the above returns are actual returns, not expected returns (which the cost of equity represents.) However, any request for an allowed ROE at or above 10.0 percent exceeds the compound and arithmetic average historical return on U.S. equities for the period mentioned above. The risk of a regulated public utility, as measured by the capital asset pricing model beta, is typically below the theoretical average beta for all stocks of 1.0. I discuss the average beta (1.00) of six publicly-traded local telecommunications service providers later.

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[1] Siegel, Jeremy J. *Stocks for the Long Run*, third edition. McGraw-Hill, New York. 2002. p.13.

**Q. Have investment professionals estimated the expected long-run return for equities in general?**

A. Yes. In a 2003 *Journal of Portfolio Management* article, Antii Ilmanen, a Managing Director of Citigroup, estimated future long-term stock returns in general to range from 5 percent to 8 percent.[2] In 2002, Dimson, Marsh, and Staunton published their estimate of the long-run expected real return on global equities of 7 percent.[3]

**Capital Structure and Risk**

**Q. How is risk defined?**

A. Modern portfolio theory ("MPT") separates risk into two categories; market risk and unique risk. Market risk is defined as the sensitivity of an investment's returns to market returns. Market risk, also known as systematic risk, is the risk related to economy-wide perils that threaten all businesses such as changes in interest rates, inflation, and general business cycles. Market risk is the only type of risk that affects the cost of equity. The most prevalent measure of market risk is "beta." Beta is the measurement of an investment's market risk, and it reflects both the business risk and financial risk of a firm.

Unique risk, or firm-specific risk, is risk that can be eliminated by portfolio diversification, i.e. buying securities in portfolios. Unique risk is not measured by beta nor does it factor into the cost of equity because it can be eliminated through simple shareholder diversification. Unique risks are peculiar to an individual company or investment project. Investors who hold diversified portfolios do not require additional return for unique risk; therefore, it does not affect the cost of capital. Additionally,

[2] Ilmanen, Antii. " Expected Returns on Stocks and Bonds." *Journal of Portfolio Management.* Winter 2003.
[3] Dimson, Elroy, Marsh, Paul, and Mike Staunton. *Triumph of the Optimists.* 2002. Princeton University Press. p. 214.

investors who choose to be less than fully diversified cannot expect to be compensated for unique risk, as it can be easily (and virtually costlessly) eliminated.

**Q. Please distinguish between business risk and financial risk.**

A. Business risk is the risk associated with the fluctuation in earnings before interest and other fixed security obligations due to the basic nature of a firm's business. To the extent a firm's earnings are affected by overall macroeconomic activity, its beta and cost of equity will be affected.

Financial risk is the risk to shareholders caused by a firm's reliance on debt financing. When a firm uses debt to finance its assets; demand, operating costs, and earnings before interest and taxes are not affected. However, the fixed interest obligations associated with debt increases the uncertainty of after-interest earnings. Hence, beta reflects both the business risk and financial risk of the firm.

**Q. What is the relationship between the capital structure and financial risk?**

A. A greater percentage of debt in a capital structure results in a higher level of financial risk.

**Q. How does Qwest's capital structure compare to capital structures of publicly traded local telecommunications service providers?**

A. Schedule JR-4 shows the capital structures of six publicly traded local telecommunications service providers ("sample telcos") as of the first quarter of 2004, as well as Qwest's capital structure. As of March 2004, the sample telcos were capitalized with approximately 49 percent debt and 51 percent equity, while Qwest's capital structure consists of approximately 75 percent debt and only 25 percent equity. Shareholders bear financial risk to the extent a company uses debt to finance assets. Qwest's shareholders bear a significantly greater amount of financial risk than shareholders in the sample telcos. Staff addresses the effect of Qwest's capital structure on its cost of equity later in this testimony.

**Fair and Reasonable Return on Equity**

**Q. Define the term "cost of equity."**

A. A firm's cost of equity is that rate of return that investors expect to earn on their equity investment given the risk of the firm. An investor's expected return is equally defined as the return on equity that she expects on other investments of similar risk.

**Q. What models did Staff use to estimate Qwest's cost of equity?**

A. The cost of equity is determined by the market. Therefore, Staff used two market-based models: the discounted cash flow ("DCF") model and the capital asset pricing model ("CAPM"). Staff applied these two models to publicly traded stocks to estimate Qwest's cost of equity.

**Q. Did Staff apply the DCF model and the CAPM to Qwest directly?**

A. No, Staff did not apply the models directly to Qwest because Qwest Corporation does not have publicly traded stock, and Staff therefore lacks the information necessary to apply the market-based models. Staff used a sample of publicly traded local telecommunications service providers as a proxy.

**Q. What companies did Staff select as proxies or comparables for Qwest?**

A. Staff selected the six sample telcos shown in Schedule JR-2. These companies are followed by *The Value Line Investment* Survey ("Value Line") and are the same companies used by Qwest in its cost of equity analysis.

**Discounted Cash Flow Model Analysis**

**Q. Please provide a brief summary of the theory upon which the DCF method of estimating the cost of equity is based.**

A. The DCF method of estimating the cost of equity is based upon the theory that the market price of a stock is equal to the present value of all expected future dividends. Through a mathematical restatement, the discount rate, or cost of capital, can be derived from the expected dividend, the stock price, and a dividend growth rate. The formula is generally applied to a sample of companies that exhibit similar risk to the company in question, and the resulting estimates for the discount rates (or costs of equity) are then averaged.

Use of the DCF method for estimating the cost of equity to a public utility was pioneered by Professor Myron Gordon in the 1960's, and it has become the most widely used model. In 1998, Professor Gordon said the following about the simplicity of his model when he gave the keynote Address at the 30th Financial Forum of the Society of Utility and Regulatory Financial Analysts:

> On its simplicity, the model made it extremely difficult, if not impossible, for a banker from Goldman Sachs or some other Wall Street firm, or for a finance professor from a prestige university to use the authority of his/her position to make extravagant claims before a regulatory agency. An independent expert or a member of a commission staff with far less impressive credentials could

politely, firmly and effectively deflate any bombast in their testimony.[4]

**Q. How did Staff apply the DCF Model?**

A. Staff applied the DCF model using two different approaches. Staff's first approach used the constant-growth DCF model. Staff's second approach was to use a non-constant growth, or multi-stage DCF. The advantage of the multi-stage DCF is that it does not assume that dividends grow at a constant rate over time.

*The Constant-Growth DCF*

**Q. What is the constant-growth DCF formula used in Staff's analysis?**

A. The constant-growth DCF formula used in Staff's analysis is:

Equation 1:

$$K = \frac{D_1}{P_0} + g$$

where: $K$ = the cost of equity
$D_1$ = the expected annual dividend
$P_0$ = the current stock price
$g$ = the expected infinite annual growth rate of dividends

The constant-growth DCF model shown in Equation 1 assumes that a company has a constant payout ratio and that its earnings are expected to grow at a constant rate. Thus, if a stock has a market price of $5 per share, an expected annual dividend of $.25 per share, and if its dividends were expected to grow 3 percent per year, then the cost of equity to the

[4] Gordon, M. J. Keynote Address at the 30th Financial Forum of the Society of Utility and Regulatory Financial Analysts. May 8, 1998. Transparency 2.

company would be 8.0 percent (the 5 percent dividend yield plus the growth rate of 3 percent per year).

**Q. How did Staff calculate the dividend yield component ($D_1/P_0$) of the constant-growth DCF formula?**

A. Staff calculated the yield component of the DCF formula by dividing the expected annual dividend by the spot stock price after the close of the market on August 18, 2004, as reported by Yahoo Finance. Staff's estimate of the average expected dividend yield for the sample telcos is 4.1 percent (see Schedule JR-3).

Staff used the spot stock price because it reflects all publicly available information. According to the efficient markets hypothesis, the current stock price includes investors' expectations of future returns and is the best indicator of these expectations.

**Q. How did Staff estimate the dividend growth (g) component of the DCF model?**

A. The DCF model is predicated on dividend growth, as shown by Equation 1. Therefore, Staff examined a combination of historical dividends per share ("DPS") growth and projections of future DPS growth provided by Value Line. Staff also examined historical and projected growth in earnings per share ("EPS") as well as "intrinsic" growth.

**Q. How did Staff estimate DPS growth?**

A. Staff estimated historical DPS growth by calculating the average rate of growth in dividends per share of the sample telcos from 1998 to 2003. The results of the analysis are shown in Schedule JR-5. Staff's analysis indicates an average historical DPS growth rate of 4.3 percent for the sample telcos.

**Q. What DPS growth rate does Value Line project for the sample companies?**

A. Value Line projects a 5.4 percent DPS growth rate for the sample telcos, shown in Schedule JR-5.

**Q. Why did Staff examine EPS growth to estimate the expected dividend growth component of the constant-growth DCF model?**

A. Staff examined EPS growth because dividend growth does not occur independently of earnings. It would be virtually impossible for dividend growth to exceed earnings growth over the long run, as it would ultimately lead to payout ratios in excess of 100 percent, which are not sustainable. Therefore, Staff considered historical and projected growth in EPS in estimating expected dividend growth.

**Q. What is Staff's historical EPS growth rate?**

A. Schedule JR-5 shows Staff's historical average rate of growth in EPS for the sample telcos. Staff's average historical EPS growth rate for the period 1998 to 2003 is 3.6 percent for the sample telcos.

**Q. What EPS growth rate does Value Line project?**

A. Value Line projects a 6.1 percent EPS growth rate for the sample telcos, also shown in Schedule JR-5.

One should note that analysts' projections of future earnings are generally high,[5] and vary widely depending on the source.

**Q. How did Staff calculate intrinsic growth?**

A. Intrinsic growth is the sum of the retention growth rate term, *br*, and the stock financing growth rate term, *vs*. These terms are discussed below.

**Q. What is retention growth?**

A. Retention growth is simply the product of the percentage of earnings retained by the company ("retention ratio") and the book/accounting return on equity. This concept is based upon the theory that dividend growth can only be achieved if a company retains and reinvests a portion of its earnings in itself to earn a return.

**Q. What is the formula for the retention growth rate?**

A. The retention growth rate formula is:

Equation 2:

$$g = br$$

where: $g$ = retention growth
$b$ = the retention ratio (1 – dividend payout ratio)
$r$ = the accounting/book return on common equity

[5] See Seigel, Jeremy J. Stocks for the Long Run. 2002. McGraw-Hill. New York. p. 100. Malkiel, Burton G. A Random Walk Down Wall Street. 1999. W.W. Norton & Co. New York. p. 169. Dreman, David. Contrarian Investment Strategies: The Next Generation. 1998. Simon & Schuster. New York. pp. 97-98. Testimony of Professors Myron J. Gordon and Lawrence I. Gould, consultant to the Trial Staff (Common Carrier Bureau), FCC Docket 79-63, p. 95.

**Q. What retention (*br*) growth rate did Staff calculate for the sample telcos?**

A. Staff calculated an average retention (*br*) growth rate of 9.6 percent for the sample telcos, as shown in Schedule JR-6. Staff calculated the rate by averaging the retention growth rate for the five years 1999 to 2003.

**Q. Does Value Line project retention growth?**

A. Yes. Value Line projects a 7.8 percent retention growth rate for the sample telcos for the 2007 - 2009 period.

**Q. Under what circumstances is the br growth rate method a reasonable estimate of future dividend growth?**

A. The br growth rate is a reasonable estimate of future dividend growth if the retention ratio is fairly constant and if the market price to book value ("market-to-book") ratio is expected to equal 1.0. The average retention ratio of the sample telcos has remained relatively stable over the past several years. However, the average market-to-book ratio of the sample telcos is 2.3. (See Schedule JR-7.) Staff assumes that investors expect the market-to-book ratio to remain above 1.0.

**Q. What is the financial implication of a market-to-book ratio greater than 1.0?**

A. The implication is that investors expect the sample telcos to earn book/accounting returns on equity greater than the companies' costs of equity.

**Q. How has Staff accounted for the assumption that investors expect the average market-to-book ratio of the sample telcos to remain above 1.0?**

A. Staff adjusted the *br* growth rate to account for the assumption that investors expect the average market-to-book ratio of the sample telcos to remain above 1.0 by adding a second growth term to its *br* growth rate to arrive at the "intrinsic" growth rate.

**Q. What is the second growth term Staff used to account for the assumption that investors expect the average market-to-book ratio of the sample telcos to remain above 1.0?**

A. The second growth term, derived by Myron Gordon in his book, *The Cost of Capital to a Public Utility*[6], is found by multiplying a variable, *v*, by another variable, *s*. Staff will refer to the product of *v* and *s* as the *vs*, or stock financing growth term. The *vs* growth term represents the company's dividend growth through the sale of stock.

**Q. What does the variable *v* represent and how is it calculated?**

A. The variable *v* represents the fraction of the funds raised from common stock sales that accrues to existing shareholders. It is calculated as follows:

Equation 3:

$$v = 1 - \left(\frac{\textit{book value}}{\textit{market value}}\right)$$

For example, if a share of stock with a $10 book value is selling for $13, the v term would equal 0.23 (calculated as 1-[$10/$13]).

**Q. What does the variable *s* represent and how is it calculated?**

[6] Gordon, Myron J. *The Cost of Capital to a Public Utility*. MSU Public Utilities Studies, Michigan, 1974. pp 31-35.

A. The variable *s* represents the expected rate of increase in common equity from stock sales. For example, if a company has $100 in equity and it sells $10 of stock then *s* would equal 10 percent ($10/$100).

**Q. How does the *vs* term work?**

A. When a utility is expected to earn a book/accounting return equal to its cost of equity, its market price will equal its book value and *v* will equal zero (0.0) (calculated as 1-($10/$10)). If a utility is expected to earn more than its cost of equity, then its market-to-book ratio will be greater than 1.0. When new shares are sold and the market-to-book ratio is greater than 1.0 causing *v* to be positive, then the book value per share of outstanding stock is less than the per share contributions of new shareholders. The per-share contribution in excess of book value per share accrues to the old shareholders in the form of a higher book value. The resulting higher book value leads to higher expected earnings and dividends. Thus, the growth term in the basic DCF model should include the *vs* growth term when the market-to-book ratio is not expected to equal 1.0. Staff's *vs* growth term for each of the sample telcos is shown in Schedule JR-6.

**Q. Shouldn't utilities' market-to-book ratios fall to 1.0 if their authorized ROEs are set equal to their costs of equity?**

A. Yes. Utilities' market-to-book ratios should fall to 1.0, in theory, making the *vs* term unnecessary. Setting the authorized return on equity for a utility equal to its cost of equity should eventually result in a market price for that utility equal to its book value. In principle, then, the *vs* term is unnecessary in the long run. In reality, rate orders do not force market-to-book ratios to 1.0 for a variety of reasons. For example, regulatory commissions do not issue orders simultaneously for multi-jurisdictional utilities, and a company may have earnings that are unregulated. Therefore, Staff included the *vs* growth term in its DCF analysis, even though the resulting growth rate estimate might be too high. Staff's resulting estimates are too high to the extent that investors expect the sample's average market-to-book ratio to fall to 1.0 because of falling authorized ROEs.

**Q. What is Staff's intrinsic growth rate and how was it calculated?**

A. Schedule JR-6 shows Staff's estimate of the intrinsic growth rate for the sample telcos. Staff's intrinsic growth rate is 11.2 percent using historical retention growth and 9.5 percent using retention growth projected by Value Line. The intrinsic growth rate was calculated by adding the *br* and *vs* growth rates.

**Q. What is Staff's expected infinite annual growth rate in dividends?**

A. Schedule JR-8 shows Staff's calculation of expected dividend growth. Staff's estimate of the expected annual dividend growth rate is also shown in the following table:

**Table 1**

| **Growth Rate** | g |
|---|---|
| Historical Dividends Per Share | 4.3% |
| Projected Dividends Per Share | 5.4% |
| Historical Earnings Per Share | 3.6% |
| Projected Earnings Per Share | 6.1% |
| Historical Intrinsic Growth | 11.2% |
| Projected Intrinsic Growth | 9.5% |
| **Average** | **6.7%** |

**Q. What is the result of Staff's constant-growth DCF analysis?**

A. Schedule JR-3 shows the result of Staff's constant-growth DCF analysis. Staff's constant-growth DCF cost of equity estimate is also shown below:

**Table 2**

| $D_1/P_0$ | + | g | = | k |
|---|---|---|---|---|
| 4.1% | + | 6.7% | = | **10.8%** |

*The Multi-Stage DCF*

**Q. What is the multi-stage DCF formula?**

A. The multi-stage DCF formula is shown in the following equation:

Equation 4:

$$P_0 = \sum_{t=1}^{n} \frac{D_t}{(1+K)^t} + \frac{D_n(1+g_n)}{K-g_n}\left[\frac{1}{(1+K)}\right]^n$$

Where: $P_0$ = current stock price
$D_t$ = dividends expected during stage 1
$K$ = cost of equity
$n$ = years of non – constant growth
$D_n$ = dividend expected in year n
$g_n$ = constant rate of growth expected after year n

The multi-stage DCF model shown above incorporates at least two growth rates. It assumes that investors expect a certain rate of non-constant dividend growth in the near term known as "stage-1 growth", as well as a longer-term constant rate of growth known as "stage-2 growth."

**Q. How did Staff implement the multi-stage DCF model?**

A. Staff forecasted a stream of dividends and found the cost of equity that equates the present value of the stream to the current stock price for each of the sample telcos, consistent with Equation 4.

**Q. How did Staff calculate stage-1 growth?**

A. Staff forecasted dividends four years out for each of the sample telcos using expected dividends over the next twelve months for the first year and *Value Line*'s projected DPS growth rate for the subsequent three years.

**Q. How did Staff estimate stage-2 growth?**

A. For stage-2 growth, or constant growth, Staff used the rate of growth in gross domestic product ("GDP") from 1929 to 2003, which is 6.5 percent. Historical growth in GDP is reasonable because it ultimately assumes, in the long-term, that the local telecommunications services industry will neither grow faster, nor slower, than the overall economy.

**Q. What is the result of Staff's multi-stage DCF analysis?**

A. Staff's multi-stage DCF estimate of the cost of equity to the sample telcos is 9.5 percent as shown in Schedule JR-9.

## Capital Asset Pricing Model

**Q. Please describe the capital asset pricing model.**

A. The CAPM is the best-known model of risk and return and the most popular method of estimating the cost of equity. The CAPM is the work of Nobel prize-winning economists and provides a method to estimate the risk and expected return on a risky asset. The model concludes that the expected return on a risky asset is equal to the sum of the prevailing risk-free interest rate and the market risk premium adjusted for the riskiness of the investment relative to the market. The critical assumptions of the CAPM can be summed up in the following quote from the book, *The Stock Market: Theories and Evidence*:[7]

> The [CAPM] model presents a simple and intuitively appealing picture of financial markets. All investors hold efficient portfolios and all such portfolios move in perfect lockstep with the market. Portfolios differ only in their sensitivity to the market. Prices of all risky assets adjust so that their returns are appropriate, in terms of the model, to their riskiness. This riskiness is measured by a simple statistic, beta, which indicates the sensitivity of the asset to market movements.

[7] Lorie, James, Mary T. Hamilton. *The Stock Market: Theories and Evidence*. Richard D. Irwin, Inc. Homewood, Illinois. 1973. p. 202.

**Q. What is the CAPM formula?**

A. The CAPM formula is shown in the following equation:

Equation 5:

$$K = R_f + \beta (R_m - R_f)$$

where:

$R_f$ = risk free rate

$R_m$ = return on market

$\beta$ = beta

$R_m - R_f$ = market risk premium

$K$ = expected return

**Q. How was the CAPM implemented to estimate Qwest's cost of equity?**

A. Staff implemented the CAPM on the same sample telcos to which it applied the DCF model.

**Q. What risk-free rate of interest did Staff estimate?**

A. Staff estimated the risk-free rate to be 3.8 percent. The estimate is based upon an average of intermediate-term U.S. Treasury securities' spot rates published in *The Wall Street Journal.* Published rates, as determined by the capital markets, are objective, verifiable, and readily available, as opposed to rates published by a forecasting service which are not necessarily objective, and are certainly not necessarily verifiable or readily available. Staff averaged the yields-to-maturity of three intermediate-term[8] (five-, seven-, and ten-

[8] The use of intermediate-term securities is based on the theoretical specification that the time to maturity approximates the investor's holding period, and assumes that most investors consider the intermediate time frame (5-10 years) a more appropriate investment horizon. See Reilly, Frank K., and Keith C. Brown. Investment Analysis and Portfolio Management. 2003. South-Western. Mason, OH. p. 439.

year) U.S. Treasury securities quoted in the August 19, 2004, edition of *The Wall Street Journal*. Intermediate-term rates averaged 3.8 percent.[9]

**Q. What beta (β) did Staff use?**

A. Staff used the average of the Value Line and Merrill Lynch betas for the six sample telcos in its analysis. Column 'J' of Schedule JR-7 shows that the average of the Value Line and Merrill Lynch betas for the sample telcos is 1.00.

**Q. Please describe the expected market risk premium ($R_m - R_f$).**

A. The expected market risk premium is the amount of additional return that investors expect from investing in the market (or an average-risk security) over the risk-free asset.

**Q. What is Staff's estimate of the expected market risk premium?**

A. Staff's estimate for the market risk premium is 7.6 percent to 8.2 percent.

**Q. How did Staff calculate the expected market risk premium?**

A. Two approaches were used. The first approach is an estimate of the historical market risk premium. The second approach is an estimate of the current market risk premium.

**Q. Please describe Staff's first approach to estimating the market risk premium: estimating the historical market risk premium.**

[9] Average yield on 5-, 7-, and 10-year Treasury notes according to the August 19, 2004, edition of *The Wall Street Journal*: 3.40%, 3.84%, and 4.22%, respectively.

A. For the first approach, Staff assumed that the average historical market risk premium is a reasonable estimate of the expected market risk premium. If one consistently uses the long-run average market risk premium to estimate the expected market risk premium, one should, on average, be correct.

Staff used the historical intermediate-term market risk premium published in Ibbotson Associates' *Stocks, Bonds, Bills and Inflation 2004 Yearbook* for the 78-year period from 1926 to 2003. Ibbotson Associates' calculation is the arithmetic average difference between S&P 500 returns and intermediate-term government bond income returns. The 78-year period is used to eliminate shorter-term biases while at the same time including unexpected past events including business cycles. Staff's market risk premium estimate using this approach is 7.6 percent.

**Q. Please describe the second approach to estimating the market risk premium: estimating the current market risk premium.**

A. Staff's second approach essentially boils down to inserting a DCF-derived ROE into the CAPM equation, along with a beta and long-term risk-free rate, and solving the CAPM equation for the implied market risk premium. Value Line projects the expected dividend yield (next 12 months) and growth for all dividend-paying stocks under its review. According to the August 13, 2004, edition of Value Line, the expected dividend yield is 1.7 percent and the expected annual growth in share price is 11.58 percent.[10] Therefore, the constant-growth DCF estimate of the cost of equity to all dividend-paying stocks

[10] 3 to 5 year price appreciation potential is 55%. $1.55^{1/4} - 1 = 11.58\%$

followed by Value Line is 13.28 percent. Using a beta of 1.00 and the current long-term risk-free rate of 5.03 percent, the implied current market risk premium is 8.25 percent.[11]

**Q. What are the results of Staff's CAPM analysis?**

A. Schedule JR-3 shows the result of Staff's CAPM analysis. Staff's CAPM cost of equity estimate is 11.7 percent.

## II. FINAL COST OF EQUITY ESTIMATES

**Q. Please summarize the results of Staff's cost of equity analysis.**

A. The following table shows the results of Staff's cost of equity analysis:

**Table 3**

| Method | Estimate |
|---|---|
| Average DCF Estimate | 10.2% |
| Average CAPM Estimate | 11.7% |
| **Overall Average** | **10.9%** |

Staff's average estimate of the cost of equity to the sample telcos is 10.9 percent.

**Q. Did Staff examine any other companies in its cost of equity analysis?**

A. Yes. As a reasonableness check, Staff calculated DCF and CAPM estimates of the cost of equity to a sample of twenty-five non-telecommunications companies ("non-telcos") identified by the Company as "comparable to [Qwest Corporation] in the risk exposure

[11] 13.28% = 5.03% + 1.00 x (current market risk premium); 8.25% = current market risk premium (decimals may not match due to rounding.)
A long-term rate is used here because the constant-growth DCF model does not assume a holding period other than infinity. Therefore, a long-term risk-free rate is used for consistency.

offered to investors." (See direct testimony of Peter C. Cummings. P. 32 at 1 – 14.)[12] Staff's average estimate of the cost of equity to the non-telcos is 10.8 percent, shown in Schedule JR-14.

**The Effect of Qwest's Capital Structure on its Cost of Equity**

**Q. Does Qwest's cost of equity depend on its capital structure?**

A. Yes. As a company increases leverage (debt) its cost of equity goes up lockstep with beta. The average capital structure of the sample telcos consists of approximately 49 percent debt. As mentioned previously, Qwest's capital structure is composed of 75 percent debt. Therefore, Qwest's shareholders bear a significantly greater amount of financial risk and require a higher return on their equity investment.

**Q. Is there an accepted formula by which the effect of Qwest's capital structure on its cost of equity can be estimated?**

A. Yes. The effect that a company's capital structure has on its cost of equity can be estimated by using the methodology developed by Professor Robert Hamada of the University of Chicago, which incorporates capital structure theory with the CAPM.

**Q. Please explain this methodology.**

A. The Value Line and Merrill Lynch betas for the sample telcos are "levered" betas – they reflect investors' perceptions of both the business risks and financial risks of the firms. In other words, one portion of the levered beta is related to the business risk of the firm and one portion of the levered beta is related to the financial risk of that firm. We already know the capital structures and levered beta for each of the sample telcos. Therefore, if

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[12] Staff eliminated companies not followed by Value Line and companies with negative equity.

we remove from each firm's beta that portion of risk related to the use of debt, we can estimate what the firm's beta would be if it were financed entirely with equity capital. This is known as the "unlevered" beta. The following equation is used to estimate the unlevered beta for a firm:

$$\beta_{UL} = \frac{\beta_L}{1 + BD \div EC\,(1-t)}$$

Where:

$\beta_{UL}$ = unlevered beta
$\beta_L$ = levered beta
$BD$ = book debt
$EC$ = equity capital
$t$ = tax rate

**Q. Did Staff calculate unlevered betas for the sample telcos?**

A. Yes. Schedule JR-10 shows how Staff calculated the unlevered beta for each of the sample telcos. The following table shows that the average raw beta[13] of the sample telcos decreases from .98 to .59 with the removal of all risk related to the use of debt. Therefore, a raw beta of .59 represents investors' perceptions of the business risks associated with the sample telcos. Additionally, .59 represents what the sample telcos' average raw beta would be if they were financed entirely with equity.

[13] Betas published by Value Line and Merrill Lynch have been "adjusted" for their presumed long-term tendency to converge toward 1.0. The adjustment process pushes high betas down toward 1.0 and low betas up toward 1.0. For purposes of calculating the capital structure adjustment to the cost of equity, Staff first "de-adjusted" the Value Line and Merrill Lynch betas to arrive at the "raw" beta, then "readjusted" the raw beta consistent with the methods used by Value Line and Merrill Lynch. The Value Line adjustment formula is [(raw beta x 0.67) + 0.35]. The Merrill Lynch adjustment formula is [(raw beta x 0.66257) + 0.33743].

**Table 5**

| Company | Avg. Value Line/Merrill Lynch (levered) Raw Beta | Unlevered Raw Beta |
|---|---|---|
| BellSouth | 0.93 | 0.66 |
| SBC Communications | 0.93 | 0.71 |
| Verizon | 0.97 | 0.51 |
| Alltel | 0.89 | 0.59 |
| CenturyTel Inc. | 1.00 | 0.64 |
| Citizens Communications | 1.17 | 0.40 |
| Average | 0.98 | 0.59 |

**Q. Is there a method by which the unlevered beta can be "relevered" using the capital structure of Qwest to arrive at a beta estimate that is representative of Qwest's financial risk?**

A. Yes. On average, the capital structures of the sample telcos are less leveraged, and reflect less financial risk than Qwest's capital structure. In order to calculate a beta estimate that is representative of Qwest's financial risk, the unlevered beta discussed above can be relevered using Qwest's capital structure. The following formula is used to calculate the relevered beta:

$$\beta_{RL} = \beta_{UL}\,(1 + (1 - t)BD \div EC)$$

Where:

$\beta_{RL}$ = relevered beta
$\beta_{UL}$ = unlevered beta
$t$ = tax rate
$BD$ = book debt
$EC$ = equity capital

Schedule JR-11 shows Staff's calculation of the relevered beta. Staff has calculated the relevered raw beta to be 1.68. When adjusted, the relevered raw beta becomes 1.46.

**Q. Can the relevered beta be used to estimate the effect of Qwest's capital structure on its cost of equity?**

A. Yes. Once the relevered beta has been determined, the CAPM can be used to estimate the impact of Qwest's capital structure on its cost of equity. Schedule JR-12 shows Staff's calculation of the CAPM risk premium ($\beta \times R_p$) using the average Value Line and Merrill Lynch levered beta (lines 1 – 3) as well as the relevered beta of 1.46 (lines 6 – 8) for Qwest's capital structure. Line 10, column D of the same schedule shows the required capital structure adjustment to the cost of equity. This is the simple difference between the risk premium estimate derived from the average Value Line/Merrill Lynch levered beta and the estimate derived from the relevered beta:

**Table 6**

| | $\beta$ | x | $(R_p)$ | = | $[\beta \times R_p]$ |
|---|---|---|---|---|---|
| Historical MRP | 1.00 | x | 7.6% | = | 7.6% |
| Current MRP | 1.00 | x | 8.2% | = | 8.2% |
| Average | | | | | 7.9% |
| Historical MRP | 1.46 | x | 7.6% | = | 11.1% |
| Current MRP | 1.46 | x | 8.2% | = | 12.0% |
| Average | | | | | 11.6% |
| Cap. Struc./Financial Risk Adjustment | | | | | 3.7% |

As shown in Table 6, Staff estimates Qwest's cost of equity to be approximately 370 basis points, or 3.7 percent, higher than the average cost of equity to the sample telcos. Based on Staff's estimate of the average cost of equity to the sample telcos of 10.9 percent (Schedule JR-3) and Staff's capital structure/financial risk adjuster for Qwest of 3.7 percent, Staff's estimate of Qwest's cost of equity is 14.6 percent (10.9% + 3.7%).

## III. ROE RECCOMENDATION

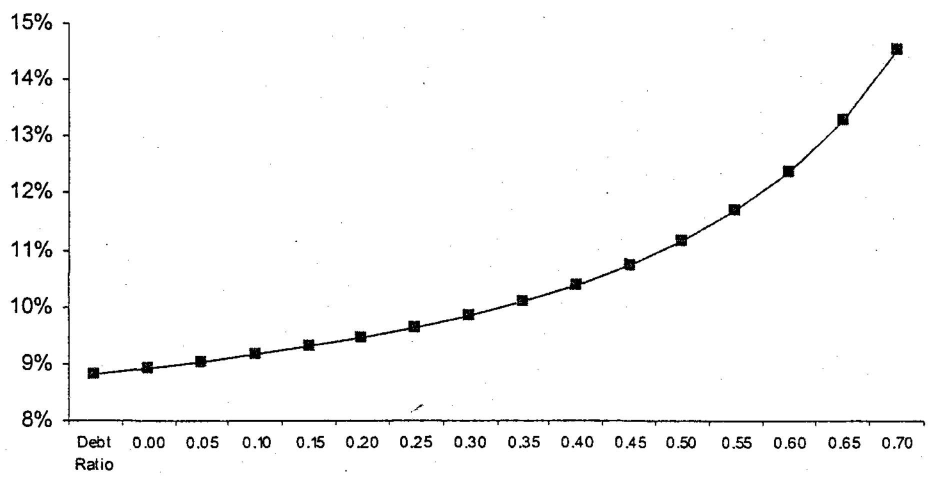
**Q. What is Staff's ROE recommendation for Qwest?**

A. Staff's estimate of Qwest's cost of equity is 14.6 percent assuming the Commission adopts Qwest's actual capital structure of 75.2 percent debt. Therefore, Staff recommends a ROE of 14.6 percent.

**Q. Is Staff's ROE recommendation for Qwest dependent upon the capital structure adopted by the Commission?**

A. Yes. Because the cost of equity increases with the use of debt, Qwest has a higher cost of equity than the sample telcos, on average. The following chart shows Staff's estimate of the current relationship between Qwest's cost of equity and its debt ratio:

**Chart 3: Qwest's Cost of Equity & Leverage**



Assuming Qwest had a debt ratio of 49 percent (the average debt ratio of the sample telcos) Staff would recommend a ROE of 10.9 percent (the average estimate of the cost of equity to the sample telcos). Additionally, assuming Qwest had no debt, Staff would recommend a ROE of approximately 9.0 percent, just as Chart 3 suggests.

## IV. COMMENT ON THE DIRECT TESTIMONY OF COMPANY WITNESS PETER C. CUMMINGS

**Q. Please summarize Mr. Cumming's ROE recommendations, analyses, and estimates.**

A. Mr. Cummings recommends a 21.4 percent ROE. He calculates DCF and CAPM estimates of the cost of equity to the same sample of telephone companies used by Staff, as well as the same group of non-telecommunications companies mentioned previously. His results are shown in the following table:

**Table 7**

| Sample | Method | Cost of Equity Estimate |
|---|---|---|
| Telephone Companies | DCF | 7.0% |
| Telephone Companies | CAPM | 12.1% |
| Non-Telephone Companies | DCF | 12.8% |
| Non-Telephone Companies | CAPM | 10.2% |

Mr. Cummings eliminates his DCF estimate for the sample telcos (7.0%) as being "at odds with both financial theory and the history of capital markets data." (See direct testimony of Peter C. Cummings. p. 33 at 20 – 21.) The average of his remaining estimates is 11.7 percent. He ultimately relies on the CAPM by relevering the average beta of both samples (using the Hamada methodology) with Qwest's capital structure to arrive at a cost of equity estimate for Qwest of 21.4 percent.

**Q. Does Staff disagree with Mr. Cummings' initial cost of equity estimates?**

A. No. Mr. Cummings' cost of equity estimates for the sample telcos average 9.6 percent and his cost of equity estimates for the non-telcos average 11.5 percent. The average of all of Mr. Cummings' cost of equity estimates is 10.5 percent. Staff agrees that 10.5 percent is a reasonable estimate of the average cost of equity to his sample.

**Q. Does Staff agree with the methods Mr. Cummings used to arrive at his initial cost of equity estimates?**

A. No. Staff does not necessarily agree with the methods he uses to arrive at his initial estimates.

Below, Staff explains why Mr. Cummings should give equal weight to his telco DCF estimate rather than excluding it. Staff also explains how Mr. Cummings' capital structure/financial risk adjustment contains errors which, when corrected, dramatically lower his final cost of equity estimate for Qwest of 21.4 percent.

**Mr. Cummings' Decision to Ignore His Telco DCF Estimate**

**Q. Why does Mr. Cummings ignore his DCF cost of equity estimate for telephone companies?**

A. According to page 33 of Mr. Cummings' direct testimony:

> The Telephone Companies DCF estimates are clearly an anomaly in the range of data. Even in the current economic environment of narrow yield spreads between corporate debt and U.S. Treasury

> securities and low interest rates, the Telco DCF equity return estimates are at or near the cost of debt for these firms... In other words, the DCF estimates imply little or no equity risk premium for investment in the common stocks of the telephone companies... Accordingly, I am giving no weight to the Telephone Company DCF estimates. (See direct testimony of Peter C. Cummings. p. 33 at 13 – 22.)

**Q. Is Mr. Cummings' reason for ignoring his Telco DCF cost of equity estimate valid?**

A. No. Mr. Cummings justifies excluding his telco DCF cost of equity estimate by comparing it to corporate bond yields. Mr. Cummings' reasoning is not valid because corporate bond rates cannot meaningfully be compared to the cost of equity. Additionally, evidence shows that Mr. Cummings' telco DCF cost of equity estimate does *not* violate the general rule of thumb that the cost of equity is higher than the yield on debt. Finally, Mr. Cummings's telco DCF cost of equity estimate is consistent with suggestions by financial economists and academics that the current market risk premium is probably lower than the historical market risk premium, and future long-term stock returns in the range of 5 to 8 percent can reasonably be expected.

**Q. Why can't corporate bond rates be meaningfully compared to the cost of equity?**

A. Corporate bond rates cannot meaningfully be compared to the cost of equity because a corporate bond contains some default risk which is diversifiable; therefore, the investor's expected rate of return is lower than the bond's yield to maturity.[14] Professor Laurence Booth of the Rotman School of Management at the University of Toronto explains:

> As for the premium over long term A bond yields, it has to be pointed out here that corporate bonds are default risky. The maximum return you can get from a corporate bond held to maturity is the yield to maturity. Since corporate bonds are default risky, the investor's expected rate of return is significantly lower than the yield to maturity. As a result, *the yield to maturity on a*

[14] Weston, J. Fred, Thomas E. Copeland. *Managerial Finance*. The Dryden Press. 1986. Chicago. Pp. 434 – 435.

> *corporate bond is not an estimate of the investor's required rate of return, and cannot be meaningfully compared to the [cost of equity]*. Only the yield to maturity on a default free government bond is an estimate of a required rate of return, similar to the [cost of equity]. This is why *all risk comparisons should be to government default free bonds, otherwise you mix apples and oranges*.[15] [emphasis added]

Regardless of whether corporate bond rates can meaningfully be compared to the cost of equity, Mr. Cummings' reason for exclusion is not valid because his telco DCF cost of equity estimate does not violate the general rule of thumb that the cost of equity is higher than the yield on debt. Four of the six sample telcos are rated 'A' or higher by Standard & Poor's. According to Value Line, the average yield on A-rated utility bonds for the period March 19, 2004 to April 1, 2004 (the approximate period over which Mr. Cummings estimates the cost of equity) was 5.51 percent – which is approximately 150 basis points *lower* than Mr. Cummings' Telco DCF cost of equity estimate of 7.0 percent.

**Q. On page 33 (lines 20 – 22) of his direct testimony Mr. Cummings states that his Telco DCF estimate of 7.0 percent is "at odds with... the history of capital markets data. Accordingly, I am giving no weight to the Telephone Company DCF estimates." Is this a valid reason for Mr. Cummings to exclude his telco DCF estimate?**

A. No. According to Mr. Cummings' schedules the average beta of the telephone companies is 1.01. A 7.0 percent average cost of equity for the telephone companies implies a 3.2 percent market risk premium (calculated as (7.0% - 3.8%) / 1.01). Such a market risk premium is consistent with suggestions by both financial economists and academics that the current equity risk premium is probably lower than the historical equity risk

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[15] Booth, Laurence. "The Importance of Market-to-Book Ratios in Regulation." *NRRI Quarterly Bulletin*. Winter 1997. pp. 415 – 425.

premium.[16] For example, Eugene Fama of the University of Chicago and Kenneth French of the Massachusetts Institute of Technology argue that the equity risk premium in the last half of the twentieth century was only 4 percent above Treasury bill rates, and they expect stocks to outperform Treasuries by only 3 percent to 3.5 percent annually in the long term.[17] Mr. Cummings' telco DCF estimate is consistent with the belief among most people who have studied the equity premium closely that "it is probably no more than a few percentage points above Treasury bills."[18]

The Chairman of the United States Federal Reserve, Alan Greenspan, even agrees that the equity risk premium has declined. In 1999, Chairman Greenspan gave a speech before a conference sponsored by the Office of the Comptroller of the Currency in Washington, D.C. in which he stated that the decline in the equity premium over the previous decade was *not* in dispute.[19]

Finally, in Section I of this testimony, Staff cited a 2003 *Journal of Portfolio Management* article in which Antii Ilmanen, a Managing Director of Citigroup, estimated future long-term stock returns in general to range from 5 percent to 8 percent. According to published CAPM betas, telephone companies are about as risky as the average security.

**Q. What are Mr. Cummings' final cost of equity estimates when his telco DCF estimate is given proper weight?**

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[16] See Dimson, Elroy. Marsh, Paul & Mike Staunton. *Triumph of the Optimists: 101 Years of Global Investment Returns*. 1st edition. Princeton University Press. 2002. pp. 193. Siegel, Jeremy J. *Stocks for the Long Run*. 3rd edition. McGraw-Hill. 2002. pp. 121 – 122.
[17] Jones, Charles P. *Investments*. 8th edition. 2002. pp. 147 – 148.
[18] Jones. p. 148.
[19] Remarks by Chairman Alan Greenspan before a conference sponsored by the Office of the Comptroller of the Currency, Washington, DC. October 14, 1999.

A. As stated previously, Mr. Cummings' cost of equity estimates for the telcos average 9.6 percent and his cost of equity estimates for the non-telcos average 11.5 percent. The average of all of his cost of equity estimates is 10.5 percent.

**Mr. Cummings' Capital Structure/Financial Risk Adjustment**

**Q. How does Mr. Cummings justify his 21.4 percent ROE recommendation?**

A. Mr. Cummings justifies his final ROE recommendation of 21.4 percent by calculating a capital structure/financial risk adjustment using the Hamada methodology, similar to the process Staff used. He unlevers the average beta of the sample telcos and comparable companies and relevers it using Qwest's capital structure. He inserts his relevered beta into the CAPM equation to produce a 21.4 percent cost of equity estimate.

**Q. Are there problems with Mr. Cummings' capital structure/financial risk adjustment?**

A. Yes. There are two problems with Mr. Cummings' capital structure/financial risk adjustment:

1. Mr. Cummings does not "de-adjust" his beta estimates before unlevering and relevering them.
2. Mr. Cummings uses the market value of equity to unlever beta, but uses a book value of equity to relever it, creating a mismatch.

As Staff explains below, correcting these problems dramatically decreases Mr. Cummings' capital structure/financial risk adjustment and his final cost of equity estimate for Qwest.

**Q. Should published beta estimates be "de-adjusted" before unlevering and relevering them?**

A. Yes. Beta estimates published by Value Line and Merrill Lynch are "Bayesian" estimates. Bayesian statistics provide a method of formally taking prior, often subjective, information or belief about a parameter (such as the presumed long-term tendency for betas to converge toward 1.0) into account in the estimation procedure.[20] De-adjusting beta estimates out of Bayesian mode and back into their classical (and objective) raw estimates gives us the original ordinary least squares ("OLS") slope, or raw beta. The classical estimate of the raw beta shows us how a particular security moved in relation to the market over some time period. Because the purpose of the Hamada methodology is to estimate how a security *would* have moved in relation to the market given different degrees of leverage, it makes sense to "de-adjust" beta estimates out of Bayesian mode and back into their classical (and objective) raw beta estimates before unlevering and relevering them. After unlevering and relevering raw beta estimates, they can then be "re-adjusted" back into Bayesian mode for comparison with betas published by Value Line and Merrill Lynch.

**Q. Is it appropriate to unlever beta with a market value of equity and relever it with a book value of equity, as Mr. Cummings does?**

A. No. It is not appropriate to unlever beta with a market value of equity and relever it with a book value of equity when there is no reasonable basis to assume market values equal book values. Mr. Cummings compares apples to oranges. In Exhibit PCC-3 of his direct testimony Mr. Cummings calculates unlevered beta estimates for his sample companies using capital structures consisting of *market* equity values which are significantly higher

[20] Wonnacott, Thomas H., & Ronald J. Wonnacott. *Introductory Statistics for Business and Economics*. 3rd ed. pp. 515, 570.

than their book values. He then relevers beta on page 36 of his direct testimony using a *book* equity value for Qwest. This is inappropriate because it makes little intuitive sense to unlever beta with a *market* equity ratio and relever it with a *book* equity ratio when evidence suggests market values are significantly higher than book values. Mr. Cummings' calculation essentially assumes that if Qwest Corporation were publicly-traded it would have a market-to-book ratio of just 1.0, compared to the average market-to-book ratio of the sample telcos of 2.3, and an average market-to- book ratio of the non-telcos of 11.8.[21]

**Q. Did Staff correct Mr. Cummings' capital structure/financial risk adjustment for these errors?**

A. Yes. Schedule JR-24 shows Staff's corrections to Mr. Cummings' capital structure/financial risk adjustment. Column 'U', line 41 of Schedule JR-24 shows Mr. Cummings' relevered beta for Qwest recalculated to incorporate (1) the de-adjusting of published betas before unlevering and relevering them, and (2) the use of book equity values rather than market equity values in the calculation. Mr. Cummings' average relevered beta for Qwest is 1.37 after making these corrections, compared to his original average relevered beta estimate of 2.15. (See direct testimony of Peter C. Cummings. p. 36 at 13 – 27.) Inserting this corrected average relevered beta estimate into Mr. Cummings CAPM produces a 15.0 percent CAPM cost of equity estimate.[22] This 15.0 percent CAPM cost of equity estimate is 380 basis points, or 3.8 percent, higher than Mr. Cummings' initial average CAPM cost of equity estimate for the sample telcos and non-telcos of 11.2 percent. (See direct testimony of Peter C. Cummings. p. 34 at 3 – 4.)

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[21] It should also be noted that Qwest's parent, QCI, has a market value of equity that is substantially greater than its book value.

[22] Calculated as $3.8\%(R_f) + 1.37(\beta) \times 8.2\%(R_p)$

**Q. Can Mr. Cummings' final cost of equity estimate for Qwest of 21.4 percent be corrected?**

A. Yes. Adding Mr. Cummings' corrected capital structure/financial risk adjuster of 380 basis points mentioned above, to his average DCF/CAPM cost of equity estimate for the sample telcos and non-telcos of 10.52 percent, produces a final cost of equity estimate for Qwest of 14.3 percent (10.52% + 3.8% = 14.3%).

This 14.3 percent cost of equity estimate can, in turn, reasonably be used as the authorized ROE for setting rates for Qwest, assuming the Commission adopts a capital structure for Qwest consisting of approximately 75 percent debt.

## V. CONCLUSION

**Q. Please summarize your recommendations.**

A. Staff recommends the Commission adopt an authorized ROE of 14.6 percent. Staff's ROE recommendation is dependent upon the capital structure adopted by the Commission in this proceeding, and assumes that the Commission will adopt Qwest's actual capital structure consisting of approximately 75 percent debt. Staff recommends the Commission give little weight to the testimony of the Company's witness, Peter C. Cummings. Mr. Cummings' final cost of equity estimate for Qwest and resulting ROE recommendation are demonstrably overstated and should not be relied upon.

**Q. Does this conclude your direct testimony?**

A. Yes, it does.

Qwest Corporation
Summary of Cost of Equity Estimates
Sample Telcos

| Line No. | [A] Sample | [B] Methodology | [C] Cost of Equity Estimate | | [D] Capital Structure/Financial Risk Adjustment | | [E] Final Cost of Equity Estimate |
|---|---|---|---|---|---|---|---|
| 1 | Sample Telcos | DCF | 10.2% | | | | |
| 2 | Sample Telcos | CAPM | 11.7% | | | | |
| 3 | | Average | 10.9% | + | 3.7% | = | 14.6% |
| 4 | | | | | | | |
| 5 | | | | | | | |
| 6 | | | | | | | |
| 7 | | | | | | | |
| 8 | | | | | | | |
| 9 | Supporting Schedules: JR-3, JR-12 | | | | | | |

Schedule JR-1

Qwest Corporation
Cost of Equity Analysis Sample Telcos

| | [A] | [B] |
|---|---|---|
| Line No. | **Sample Telcos** | **Industry** |
| 1 | BellSouth | Telecom. Services |
| 2 | SBC Communications | Telecom. Services |
| 3 | Verizon | Telecom. Services |
| 4 | Alltel | Telecom. Services |
| 5 | CenturyTel Inc. | Telecom. Services |
| 6 | Citizens Communications | Telecom. Services |

Schedule JR-2

Qwest Corporation
DCF and CAPM Cost of Equity Estimates
Sample Telcos

| Line No. | [A] | [B] | | [C] | | [D] | | [E] |
|---|---|---|---|---|---|---|---|---|
| | **DCF Method** | | | **$D_1/P_0$** | **+** | **g** | **=** | ***k*** |
| 1 | Constant Growth DCF Estimate | | | 4.1% | + | 6.7% | = | 10.8% |
| 2 | Multi-Stage DCF Estimate | | | | | | = | 9.5% |
| 3 | **Average of DCF Estimates** | | | | | | | **10.2%** |
| 4 | | | | | | | | |
| 5 | **CAPM Method** | **Rf** | **+** | **$\beta$** | **x** | **(Rp)** | **=** | ***k*** |
| 6 | Historical Market Risk Premium | 3.8% | + | 1.00 | x | 7.6% | = | 11.4% |
| 7 | Current Market Risk Premium | 3.8% | + | 1.00 | x | 8.2% | = | 12.0% |
| 8 | **Average of CAPM Estimates** | | | | | | | **11.7%** |
| 9 | | | | | | | | |
| 10 | | | | | | | | |
| 11 | | | | | | **Average** | | **10.9%** |
| 12 | | | | | | | | |
| 13 | Source: The Wall Street Journal, Value Line, Yahoo Finance, Ibbotson Associates SBBI 2004 Yearbook | | | | | | | |
| 14 | Supporting Schedules: JR-7, JR-8, JR-9 | | | | | | | |

Schedule JR-3

Qwest Corporation
Average Capital Structure of Sample Telcos

| | [A] | [B] | [C] |
|---|---|---|---|
| Line No. | Company | Debt | Equity |
| 1 | BellSouth | 39.1% | 60.9% |
| 2 | SBC Communications | 31.8% | 68.2% |
| 3 | Verizon | 56.7% | 43.3% |
| 4 | Alltel | 45.5% | 54.5% |
| 5 | CenturyTel Inc. | 47.3% | 52.7% |
| 6 | Citizens Communications | 75.2% | 24.8% |
| 7 | | | |
| 8 | Average Sample Telcos | 49.3% | 50.7% |
| 9 | | | |
| 10 | Qwest Corporation | 75.2% | 24.8% |
| 11 | | | |
| 12 | | | |
| 13 | | | |
| 14 | | | |
| 15 | | | |
| 16 | | | |
| 17 | Source: Value Line, Ramirez Direct Testimony | | |

Schedule JR-4

Qwest Corporation
Growth in Earnings and Dividends
Sample Telcos

| Line No. | [A] | [B] Dividends Per Share 1998 to 2003 DPS | [C] Dividends Per Share Projected DPS | [D] Earnings Per Share 1998 to 2003 EPS | [E] Earnings Per Share Projected EPS |
|---|---|---|---|---|---|
| 1 | BellSouth | 4.7% | 4.9% | 4.6% | 3.8% |
| 2 | SBC Communications | 7.8% | 0.4% | -6.1% | 2.3% |
| 3 | Verizon | 0.0% | 0.8% | -0.7% | 3.1% |
| 4 | Alltel | 3.8% | 4.0% | 7.6% | 8.4% |
| 5 | CenturyTel Inc. | 5.3% | 16.9% | 11.0% | 5.7% |
| 6 | Citizens Communications | n/a | n/a | 5.4% | 13.2% |
| 7 | | | | | |
| 8 | Average Sample Telcos | 4.3% | 5.4% | 3.6% | 6.1% |
| 9 | | | | | |
| 10 | | | | | |
| 11 | | | | | |
| 12 | Source: Value Line | | | | |

Schedule JR-5

Qwest Corporation
Docket No. T-01051B-03-0454

Qwest Corporation
Intrinsic Growth
Sample Telcos

| Line No. | [A] Company | [B] Retention Growth 1999 to 2003 br | [C] Retention Growth Projected br | [D] Stock Financing Growth vs | [E] Intrinsic Growth 1999 to 2003 br + vs | [F] Intrinsic Growth Projected br + vs |
|---|---|---|---|---|---|---|
| 1 | BellSouth | 12.1% | 8.5% | 0.0% | 12.1% | 8.5% |
| 2 | SBC Communications | 11.2% | 2.5% | 0.6% | 11.8% | 3.1% |
| 3 | Verizon | 11.9% | 9.0% | 1.8% | 13.7% | 10.8% |
| 4 | Alltel | 8.1% | 8.5% | 0.3% | 8.4% | 8.8% |
| 5 | CenturyTel Inc. | 9.3% | 8.5% | 0.2% | 9.5% | 8.7% |
| 6 | Citizens Communications | 4.8% | 10.0% | 6.9% | 11.7% | 16.9% |
| 7 | | | | | | |
| 8 | Average Sample Telcos | 9.6% | 7.8% | 1.6% | 11.2% | 9.5% |
| 9 | | | | | | |
| 10 | | | | | | |
| 11 | | | | | | |
| 12 | | | | | | |
| 13 | | | | | | |
| 14 | | | | | | |
| 15 | | | | | | |
| 16 | Source: Value Line, MSN Money | | | | | |

Schedule JR-6

Qwest Corporation
Selected Financial Data of Sample Telcos

| | [A] | [B] | [C] | [D] | [E] | [F] | [G] | [H] | [I] | [J] | [K] |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Line No. | Company | Symbol | Spot Price 8/18/04 | Book Value 8/18/04 | Mkt To Book | *Merrill Lynch* Beta $\beta$ | *Merrill Lynch* Raw Beta $\beta_{raw}$ | *Value Line* Beta $\beta$ | *Value Line* Raw Beta $\beta_{raw}$ | Average *Merrill Lynch* & *Value Line* $\beta$ | Average *Merrill Lynch* & *Value Line* Raw Beta $\beta_{raw}$ |
| 1 | BellSouth | BLS | 27.15 | 11.70 | 2.3 | 0.98 | 0.97 | 0.95 | 0.90 | 0.97 | 0.93 |
| 2 | SBC Communications | SBC | 25.58 | 11.72 | 2.2 | 0.88 | 0.82 | 1.05 | 1.04 | 0.97 | 0.93 |
| 3 | Verizon | VZ | 39.13 | 12.44 | 3.1 | 0.98 | 0.97 | 1.00 | 0.97 | 0.99 | 0.97 |
| 4 | Alltel | AT | 53.92 | 23.02 | 2.3 | 0.88 | 0.82 | 1.00 | 0.97 | 0.94 | 0.89 |
| 5 | CenturyTel Inc. | CTL | 31.55 | 24.46 | 1.3 | 0.92 | 0.88 | 1.10 | 1.12 | 1.01 | 1.00 |
| 6 | Citizens Communications | CZN | 12.45 | 5.27 | 2.4 | 1.25 | 1.38 | 1.00 | 0.97 | 1.13 | 1.17 |
| 7 | | | | | | | | | | | |
| 8 | Average | | | | 2.3 | 0.98 | 0.97 | 1.02 | 1.00 | 1.00 | 0.98 |
| 9 | | | | | | | | | | | |
| 10 | Source: Yahoo Finance, Value Line, Merrill Lynch | | | | | | | | | | |

Schedule JR-7

Qwest Corporation
Calculation of Expected Infinite Annual Growth in Dividends
Sample Telcos

| Line No. | [A] | [B] g |
|---|---|---|
| 1 | DPS Growth - Historical | 4.3% |
| 2 | DPS Growth - Projected | 5.4% |
| 3 | EPS Growth - Historical | 3.6% |
| 4 | EPS Growth - Projected | 6.1% |
| 5 | Intrinsic Growth - Historical | 11.2% |
| 6 | Intrinsic Growth - Projected | 9.5% |
| 7 | | |
| 8 | Average | 6.7% |
| 9 | | |
| 10 | | |
| 11 | | |
| 12 | Supporting Schedules: JR-5, JR-6 | |

Schedule JR-8

# Qwest Corporation
## Multi-Stage DCF Estimates
## Sample Telcos

| Line No. | [A] | [B] Current Mkt. Price ($P_o$) | [C] Projected Dividends[1] (stage 1 growth) ($D_t$) $d_1$ | [D] $d_2$ | [E] $d_3$ | [F] $d_4$ | [G] Stage 2 growth[2] ($g_n$) | [H] Equity Cost Estimate ($K$) |
|---|---|---|---|---|---|---|---|---|
| 1 | BellSouth | 27.2 | 1.08 | 1.12 | 1.16 | 1.20 | 6.5% | 10.2% |
| 2 | SBC Communications | 25.6 | 1.28 | 1.31 | 1.34 | 1.38 | 6.5% | 11.0% |
| 3 | Verizon | 39.1 | 1.54 | 1.56 | 1.58 | 1.60 | 6.5% | 9.9% |
| 4 | Alltel | 53.9 | 1.51 | 1.57 | 1.64 | 1.71 | 6.5% | 9.1% |
| 5 | CenturyTel Inc. | 31.6 | 0.28 | 0.32 | 0.37 | 0.42 | 6.5% | 7.5% |
| 6 | Citizens Communications | 12.5 | 1.00 | n/a | n/a | n/a | 6.5% | n/a |
| 7 | | | | | | | Average | 9.5% |

$$P_0 = \sum_{t=1}^{n} \frac{D_t}{(1+K)^t} + \frac{D_n(1+g_n)}{K-g_n}\left[\frac{1}{(1+K)}\right]^n$$

Where:
$P_0$ = current stock price
$D_t$ = dividends expected during stage 1
$K$ = cost of equity
$n$ = years of non – constant growth
$D_n$ = dividend expected in year n
$g_n$ = constant rate of growth expected after year n

[1] $d_1$ = "Est'd Div'd next 12 mos." 08/13/2004, *Value Line* Summary & Index.
[2] Average annual growth in GDP 1929 - 2003 in current dollars. http://www.bea.doc.gov/

Schedule JR-9

Qwest Corporation
*Calculation of Unlevered Beta*
Sample Telcos

$$\beta_{UL} = \frac{\beta_L}{1 + BD + EC\ (1 - t)}$$

Where :
$\beta_{UL}$ = unlevered beta
$\beta_L$ = levered beta
$BD$ = book debt
$EC$ = equity capital
$t$ = tax rate

| Line No. | [A] | [B] *Value Line* Levered Raw Beta $\beta_L$ | [C] *Merrill Lynch* Levered Raw Beta $\beta_L$ | [D] Average *Merrill Lynch* & *Value Line* Raw Beta $\beta_L$ | [E] Tax Rate t | [F] Book Debt BD | [G] Equity Cap EC | [H] *Value Line* Unlevered Raw Beta $\beta_{UL}$ | [I] *Merrill Lynch* Unlevered Raw Beta $\beta_{UL}$ | [J] Average *Merrill Lynch* & *Value Line* Unlevered Raw Beta $\beta_{UL}$ |
|---|---|---|---|---|---|---|---|---|---|---|
| 1 | BellSouth | 0.90 | 0.97 | 0.93 | 0.35 | 0.39 | 0.61 | 0.63 | 0.68 | 0.66 |
| 2 | SBC Communications | 1.04 | 0.82 | 0.93 | 0.33 | 0.32 | 0.68 | 0.80 | 0.62 | 0.71 |
| 3 | Verizon | 0.97 | 0.97 | 0.97 | 0.32 | 0.57 | 0.43 | 0.51 | 0.51 | 0.51 |
| 4 | Alltel | 0.97 | 0.82 | 0.89 | 0.38 | 0.46 | 0.54 | 0.64 | 0.54 | 0.59 |
| 5 | CenturyTel Inc. | 1.12 | 0.88 | 1.00 | 0.39 | 0.47 | 0.53 | 0.72 | 0.57 | 0.64 |
| 6 | Citizens Communications | 0.97 | 1.38 | 1.17 | 0.36 | 0.75 | 0.25 | 0.33 | 0.47 | 0.40 |
| 7 | | | | | | | | | | |
| 8 | Sample Telcos | 1.00 | 0.97 | 0.98 | 0.35 | 0.49 | 0.51 | 0.61 | 0.57 | 0.59 |
| 9 | | | | | | | | | | |
| 10 | | | | | | | | | | |
| 11 | | | | | | | | | | |
| 12 | | | | | | | | | | |
| 13 | | | | | | | | | | |
| 14 | Tax Rate: Value Line | | | | | | | | | |
| 15 | Supporting Schedules: JR-4, JR-7 | | | | | | | | | |

Schedule JR-10

Qwest Corporation
Calculation of Relevered Beta
Sample Telcos

$$\beta_{RL} = \beta_{UL}\ (1 + (1-t)BD + EC)$$

Where :

$\beta_{RL}$ = relevered beta
$\beta_{UL}$ = unlevered beta
$t$ = tax rate
$BD$ = book debt
$EC$ = equity capital

| Line No. | [A] | [B] *Value Line* Unlevered Raw Beta $\beta_{UL}$ | [C] *Merrill Lynch* Unlevered Raw Beta $\beta_{UL}$ | [D] Book Debt BD | [E] Equity Cap EC | [F] Tax Rate t | [G] *Value Line* Relevered Raw Beta $\beta_{RL}$ | [H] *Merrill Lynch* Relevered Raw Beta $\beta_{RL}$ | [I] Average *Value Line* & *Merrill Lynch* Raw Relevered Beta | [J] *Value Line* Adjusted Relevered Beta .35 + .67(Raw Beta) $\beta_{RL}$ | [K] *Merrill Lynch* Adjusted Relevered Beta .34 + .66(Raw Beta) $\beta_{RL}$ | [L] Average *Value Line* & *Merrill Lynch* Adjusted Relevered Beta |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Qwest Corporation | 0.61 | 0.57 | 0.75 | 0.25 | 38.3% | 1.74 | 1.62 | 1.68 | 1.51 | 1.41 | 1.46 |
| 2 | | | | | | | | | | | | |
| 3 | | | | | | | | | | | | |
| 4 | | | | | | | | | | | | |
| 5 | | | | | | | | | | | | |
| 6 | | | | | | | | | | | | |
| 7 | | | | | | | | | | | | |

8 Tax Rate: Company ApplicationSchedule C-3
9 Supporting Schedules: JR-10

Schedule JR-11

Qwest Corporation
Required Capital Structure Adjustment
Sample Telcos

| Line No. | [A] | [B] | | [C] | | [D] |
|---|---|---|---|---|---|---|
| | **Sample Telcos Average Levered Beta** | $\beta$ | **x** | **(Rp)** | **=** | **[β × Rp]** |
| 1 | Historical Market Risk Premium | 1.00 | x | 7.6% | = | 7.6% |
| 2 | Current Market Risk Premium | 1.00 | x | 8.2% | = | 8.2% |
| 3 | **Average [β × Rp]** | | | | | **7.9%** |
| 4 | | | | | | |
| 5 | **Qwest Corp. Relevered Beta** | $\beta$ | | **(Rp)** | | **[β × Rp]** |
| 6 | Historical Market Risk Premium | 1.46 | x | 7.6% | = | 11.1% |
| 7 | Current Market Risk Premium | 1.46 | x | 8.2% | = | 12.0% |
| 8 | **Average [β × Rp]** | | | | | **11.6%** |
| 9 | | | | | | |
| 10 | Capital Structure/Financial Risk Adjustment (8 - 3) | | | | | 3.7% |
| 11 | | | | | | |
| 12 | | | | | | |
| 13 | | | | | | |
| 14 | | | | | | |
| 15 | Supporting Schedules: JR-3, JR-11 | | | | | |

Schedule JR-12

Qwest Corporation
Cost of Equity Analysis Non-Telcos

| | [A] | [B] |
|---|---|---|
| Line No. | **Non-Telcos** | **Industry** |
| 1 | Abbot Labs | Pharmaceuticals |
| 2 | AFLAC | Insurance |
| 3 | Air Products | Materials & Chemicals |
| 4 | Anheuser Busch | Beverages |
| 5 | Auto. Data Proc. | IT Services |
| 6 | Barrick Gold | Precious Metals |
| 7 | Brown-Forman | Beverages |
| 8 | California Water | Water Utility |
| 9 | Coca-Cola | Beverages |
| 10 | Colgate-Palmolive | Household Products |
| 11 | Danaher Corp. | Machinery |
| 12 | Ecolab Inc. | Materials & Chemicals |
| 13 | Emerson Electric | Electrical Equipment |
| 14 | E.W. Scripps | Media |
| 15 | Gillette | Personal Products |
| 16 | Illinois Tool Works | Machinery |
| 17 | Johnson & Johnson | Pharmaceuticals |
| 18 | Legget & Platt | Leggett & Platt |
| 19 | McDonald's Corp. | Hotels & Resaurants |
| 20 | MGIC Investment | Thrifts & Mortgage |
| 21 | Sherwin-Williams | Specialty Retail |
| 22 | UnitedHealth Grp. | Health Care Providers |
| 23 | UST Inc. | Tobacco |
| 24 | Vulcan Materials | Construction Materials |
| 25 | WPS Resources | Electric Utility |

Schedule JR-13

Qwest Corporation
DCF and CAPM Cost of Equity Estimates
Non-Telcos

| Line No. | [A] | [B] | | [C] | | [D] | | [E] |
|---|---|---|---|---|---|---|---|---|
| | **DCF Method** | | | **$D_1/P_0$** | **+** | **g** | **=** | ***k*** |
| 1 | Constant Growth DCF Estimate | | | 1.9% | + | 12.8% | = | 14.8% |
| 2 | Multi-Stage DCF Estimate | | | | | | = | 8.2% |
| 3 | **Average of DCF Estimates** | | | | | | | **11.5%** |
| 4 | | | | | | | | |
| 5 | **CAPM Method** | **Rf** | **+** | ***β*** | **x** | **(Rp)** | **=** | ***k*** |
| 6 | Historical Market Risk Premium | 3.8% | + | 0.79 | x | 7.6% | = | 9.8% |
| 7 | Current Market Risk Premium | 3.8% | + | 0.79 | x | 8.2% | = | 10.3% |
| 8 | **Average of CAPM Estimates** | | | | | | | **10.0%** |
| 9 | | | | | | | | |
| 10 | | | | | | | | |
| 11 | | | | | | **Average** | | **10.8%** |
| 12 | | | | | | | | |
| 13 | Source: The Wall Street Journal, Value Line, Yahoo Finance, Ibbotson Associates SBBI 2004 Yearbook | | | | | | | |
| 14 | Supporting Schedules: JR-18, JR-19, JR-20 | | | | | | | |

Schedule JR-14

Qwest Corporation
Docket No. T-01051B-03-0454

Qwest Corporation
Average Capital Structure of Non-Telcos

| Line No. | [A] Company | [B] Debt | [C] Equity |
|---|---|---|---|
| 1 | Abbot Labs | 33.0% | 67.0% |
| 2 | AFLAC | 17.3% | 82.7% |
| 3 | Air Products | 40.5% | 59.5% |
| 4 | Anheuser Busch | 72.1% | 27.9% |
| 5 | Auto. Data Proc. | 1.6% | 98.4% |
| 6 | Barrick Gold | 17.9% | 82.1% |
| 7 | Brown-Forman | 37.2% | 62.8% |
| 8 | California Water | 52.7% | 47.3% |
| 9 | Coca-Cola | 31.0% | 69.0% |
| 10 | Colgate-Palmolive | 89.0% | 11.0% |
| 11 | Danaher Corp. | 24.7% | 75.3% |
| 12 | Ecolab Inc. | 37.3% | 62.7% |
| 13 | Emerson Electric | 39.2% | 60.8% |
| 14 | E.W. Scripps | 19.6% | 80.4% |
| 15 | Gillette | 57.6% | 42.4% |
| 16 | Illinois Tool Works | 11.0% | 89.0% |
| 17 | Johnson & Johnson | 11.3% | 88.7% |
| 18 | Legget & Platt | 34.6% | 65.4% |
| 19 | McDonald's Corp. | 44.3% | 55.7% |
| 20 | MGIC Investment | 13.3% | 86.7% |
| 21 | Sherwin-Williams | 25.6% | 74.4% |
| 22 | UnitedHealth Grp. | 27.9% | 72.1% |
| 23 | UST Inc. | 98.6% | 1.4% |
| 24 | Vulcan Materials | 32.4% | 67.6% |
| 25 | WPS Resources | 46.6% | 53.4% |
| 26 | | | |
| 27 | | | |
| 28 | Average Company Sample | 36.7% | 63.3% |
| 29 | | | |
| 30 | Qwest Corporation | 75.2% | 24.8% |
| 31 | | | |
| 32 | | | |
| 33 | Source: Value Line, Ramirez Direct Testimony | | |

Schedule JR-15

Qwest Corporation
Growth in Earnings and Dividends
Non-Telcos

| Line No. | [A] | [B] Dividends Per Share 1998 to 2003 DPS | [C] Dividends Per Share Projected DPS | [D] Earnings Per Share 1998 to 2003 EPS | [E] Earnings Per Share Projected EPS |
|---|---|---|---|---|---|
| 1 | Abbot Labs | 10.1% | 6.8% | 7.9% | 8.3% |
| 2 | AFLAC | 18.2% | 14.9% | 19.4% | 14.1% |
| 3 | Air Products | 6.6% | 4.4% | 0.0% | 15.9% |
| 4 | Anheuser Busch | 9.0% | 5.8% | 14.3% | 8.3% |
| 5 | Auto. Data Proc. | 13.0% | 7.8% | 11.0% | 10.9% |
| 6 | Barrick Gold | 4.1% | 1.8% | -16.5% | 13.4% |
| 7 | Brown-Forman | 5.3% | 4.8% | 8.1% | 8.1% |
| 8 | California Water | 0.9% | 1.0% | -3.6% | 11.1% |
| 9 | Coca-Cola | 8.0% | 10.4% | 6.5% | 9.7% |
| 10 | Colgate-Palmolive | 10.4% | 5.9% | 13.4% | 7.3% |
| 11 | Danaher Corp. | 10.8% | 9.9% | 19.3% | 12.1% |
| 12 | Ecolab Inc. | 8.8% | 9.2% | 12.2% | 13.0% |
| 13 | Emerson Electric | 5.9% | 2.3% | -2.7% | 10.9% |
| 14 | E.W. Scripps | 2.9% | 9.6% | 13.4% | 12.8% |
| 15 | Gillette | 5.0% | 1.8% | 1.1% | 11.4% |
| 16 | Illinois Tool Works | 12.8% | 5.6% | 4.8% | 16.4% |
| 17 | Johnson & Johnson | 13.7% | 11.2% | 15.0% | 10.8% |
| 18 | Legget & Platt | 10.6% | 4.2% | -3.3% | 12.6% |
| 19 | McDonald's Corp. | 17.3% | 3.7% | 2.6% | 10.0% |
| 20 | MGIC Investment | 5.4% | 9.0% | 7.0% | 11.5% |
| 21 | Sherwin-Williams | 6.6% | 10.0% | 7.6% | 11.0% |
| 22 | UnitedHealth Grp. | 14.9% | 32.0% | 35.0% | 15.9% |
| 23 | UST Inc. | 4.3% | 2.8% | 3.8% | 2.0% |
| 24 | Vulcan Materials | 7.3% | 5.0% | -2.2% | 10.6% |
| 25 | WPS Resources | 2.0% | 1.8% | 9.4% | 5.7% |
| 26 | | | | | |
| 27 | Average Company Sample | 8.5% | 7.3% | 7.3% | 11.0% |
| 28 | | | | | |
| 29 | | | | | |
| 30 | | | | | |
| 31 | Source: Value Line | | | | |

Schedule JR-16

Qwest Corporation
Intrinsic Growth
Non-Telcos

| Line No. | [A] Company | [B] Retention Growth 1999 to 2003 br | [C] Retention Growth Projected br | [D] Stock Financing Growth vs | [E] Intrinsic Growth 1999 to 2003 br + vs | [F] Intrinsic Growth Projected br + vs |
|---|---|---|---|---|---|---|
| 1 | Abbot Labs | 18.2% | 13.0% | 1.2% | 19.3% | 14.2% |
| 2 | AFLAC | 11.8% | 14.0% | 0.4% | 12.3% | 14.4% |
| 3 | Air Products | 10.6% | 12.0% | 1.4% | 12.0% | 13.4% |
| 4 | Anheuser Busch | 33.2% | 27.5% | 2.6% | 35.8% | 30.1% |
| 5 | Auto. Data Proc. | 14.4% | 23.5% | 3.0% | 17.3% | 26.5% |
| 6 | Barrick Gold | 4.6% | 4.5% | 0.4% | 5.0% | 4.9% |
| 7 | Brown-Forman | 13.7% | 12.5% | 0.4% | 14.0% | 12.9% |
| 8 | California Water | 1.8% | 5.5% | 2.5% | 4.3% | 8.0% |
| 9 | Coca-Cola | 18.9% | 18.0% | 1.5% | 20.4% | 19.5% |
| 10 | Colgate-Palmolive | 127.3% | 25.0% | 71.4% | 198.7% | 96.4% |
| 11 | Danaher Corp. | 14.4% | 14.5% | 5.1% | 19.5% | 19.6% |
| 12 | Ecolab Inc. | 15.7% | 17.0% | 3.4% | 19.1% | 20.4% |
| 13 | Emerson Electric | 8.7% | 10.0% | 0.0% | 8.7% | 10.0% |
| 14 | E.W. Scripps | 9.7% | 11.5% | 0.0% | 9.7% | 11.5% |
| 15 | Gillette | 24.7% | 27.5% | 2.9% | 27.5% | 30.4% |
| 16 | Illinois Tool Works | 11.5% | 14.0% | 0.3% | 11.8% | 14.3% |
| 17 | Johnson & Johnson | 17.0% | 15.0% | 1.6% | 18.6% | 16.6% |
| 18 | Legget & Platt | 8.1% | 7.0% | 0.3% | 8.4% | 7.3% |
| 19 | McDonald's Corp. | 15.2% | 12.0% | 0.0% | 15.2% | 12.0% |
| 20 | MGIC Investment | 19.7% | 12.5% | 0.2% | 19.9% | 12.7% |
| 21 | Sherwin-Williams | 14.5% | 15.0% | 1.4% | 15.9% | 16.4% |
| 22 | UnitedHealth Grp. | 24.5% | 29.0% | 4.4% | 28.9% | 33.4% |
| 23 | UST Inc. | 48.5% | 27.0% | -10.9% | 37.7% | 16.1% |
| 24 | Vulcan Materials | 8.7% | 9.0% | 0.0% | 8.8% | 9.0% |
| 25 | WPS Resources | 2.2% | 4.0% | 4.8% | 7.0% | 8.8% |
| 26 | | | | | | |
| 27 | Average Company Sample | 19.9% | 15.2% | | 23.8% | 19.2% |
| 28 | | | | | | |
| 29 | | | | | | |
| 30 | | | | | | |
| 31 | | | | | | |
| 32 | | | | | | |
| 33 | | | | | | |
| 34 | | | | | | |
| 35 | Source: Value Line | | | | | |

Schedule JR-17

Qwest Corporation
Selected Financial Data of Non-Telcos

| Line No. | [A] Company | [B] Symbol | [C] Spot Price 8/18/04 | [D] Book Value 8/18/04 | [E] Mkt To Book | [F] *Merrill Lynch* Beta $\beta$ | [G] *Merrill Lynch* Raw Beta $\beta_{raw}$ | [H] *Value Line* Beta $\beta$ | [I] *Value Line* Raw Beta $\beta_{raw}$ | [J] Average *Merrill Lynch* & *Value Line* $\beta$ | [K] Average *Merrill Lynch* & *Value Line* Raw Beta $\beta_{raw}$ |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Abbot Labs | ABT | 40.59 | 9.05 | 4.5 | 0.53 | 0.29 | 0.80 | 0.67 | 0.67 | 0.48 |
| 2 | AFLAC | AFL | 39.54 | 14.08 | 2.8 | 0.70 | 0.55 | 0.95 | 0.90 | 0.83 | 0.72 |
| 3 | Air Products | APD | 51.99 | 17.94 | 2.9 | 0.90 | 0.85 | 0.95 | 0.90 | 0.93 | 0.87 |
| 4 | Anheuser Busch | BUD | 53.07 | 3.98 | 13.3 | 0.27 | -0.10 | 0.60 | 0.37 | 0.44 | 0.14 |
| 5 | Auto. Data Proc. | ADP | 40.12 | 9.04 | 4.4 | 1.06 | 1.09 | 0.95 | 0.90 | 1.01 | 0.99 |
| 6 | Barrick Gold | ABX | 19.25 | 6.54 | 2.9 | n/a | n/a | 0.45 | 0.15 | 0.45 | 0.15 |
| 7 | Brown-Forman | BFB | 45.94 | 9.85 | 4.7 | n/a | n/a | 0.65 | 0.45 | 0.65 | 0.45 |
| 8 | California Water | CWT | 27.50 | 15.05 | 1.8 | n/a | n/a | 0.70 | 0.52 | 0.70 | 0.52 |
| 9 | Coca-Cola | KO | 44.57 | 6.07 | 7.3 | 0.53 | 0.29 | 0.65 | 0.45 | 0.59 | 0.37 |
| 10 | Colgate-Palmolive | CL | 52.13 | 0.86 | 60.4 | 0.65 | 0.47 | 0.70 | 0.52 | 0.68 | 0.50 |
| 11 | Danaher Corp. | DHR | 50.20 | 13.15 | 3.8 | 0.90 | 0.85 | 1.00 | 0.97 | 0.95 | 0.91 |
| 12 | Ecolab Inc. | ECL | 30.29 | 5.42 | 5.6 | 0.76 | 0.64 | 0.90 | 0.82 | 0.83 | 0.73 |
| 13 | Emerson Electric | EMR | 62.43 | 16.26 | 3.8 | 0.95 | 0.92 | 1.05 | 1.04 | 1.00 | 0.98 |
| 14 | E.W. Scripps | SSP | 101.15 | 24.30 | 4.2 | 0.68 | 0.52 | 0.90 | 0.82 | 0.79 | 0.67 |
| 15 | Gillette | G | 40.85 | 2.27 | 18.0 | 0.50 | 0.25 | 0.65 | 0.45 | 0.58 | 0.35 |
| 16 | Illinois Tool Works | ITW | 90.97 | 26.26 | 3.5 | 0.91 | 0.86 | 1.00 | 0.97 | 0.96 | 0.92 |
| 17 | Johnson & Johnson | JNJ | 57.03 | 9.71 | 5.9 | 0.51 | 0.26 | 0.70 | 0.52 | 0.61 | 0.39 |
| 18 | Legget & Platt | LEG | 27.41 | 11.28 | 2.4 | 1.02 | 1.03 | 1.05 | 1.04 | 1.04 | 1.04 |
| 19 | McDonald's Corp. | MCD | 26.48 | 10.07 | 2.6 | 0.86 | 0.79 | 1.05 | 1.04 | 0.96 | 0.92 |
| 20 | MGIC Investment | MTG | 68.50 | 40.99 | 1.7 | 1.01 | 1.02 | 1.15 | 1.19 | 1.08 | 1.10 |
| 21 | Sherwin-Williams | SHW | 39.93 | 10.85 | 3.7 | 0.81 | 0.71 | 1.00 | 0.97 | 0.91 | 0.84 |
| 22 | UnitedHealth Grp. | UNH | 65.07 | 13.03 | 5.0 | 0.54 | 0.31 | 0.65 | 0.45 | 0.60 | 0.38 |
| 23 | UST Inc. | UST | 38.77 | 0.31 | 125.1 | 0.58 | 0.37 | 0.90 | 0.82 | 0.74 | 0.59 |
| 24 | Vulcan Materials | VMC | 47.72 | 18.52 | 2.6 | 0.83 | 0.74 | 1.05 | 1.04 | 0.94 | 0.89 |
| 25 | WPS Resources | WPS | 47.70 | 28.08 | 1.7 | n/a | n/a | 0.75 | 0.60 | 0.75 | 0.60 |
| 26 | | | | | | | | | | | |
| 27 | Average | | | | 11.8 | 0.74 | 0.60 | 0.85 | 0.74 | 0.79 | 0.66 |
| 28 | | | | | | | | | | | |
| 29 | Source: Yahoo Finance, Value Line, Merrill Lynch | | | | | | | | | | |

Qwest Corporation
Calculation of Expected Infinite Annual Growth in Dividends
Non-Telcos

| Line No. | [A] | [B] g |
|---|---|---|
| 1 | DPS Growth - Historical | 8.5% |
| 2 | DPS Growth - Projected | 7.3% |
| 3 | EPS Growth - Historical | 7.3% |
| 4 | EPS Growth - Projected | 11.0% |
| 5 | Intrinsic Growth - Historical | 23.8% |
| 6 | Intrinsic Growth - Projected | 19.2% |
| 7 | | |
| 8 | Average | 12.8% |
| 9 | | |
| 10 | | |
| 11 | | |
| 12 | Supporting Schedules: JR-16, JR-17 | |

Schedule JR-19

Qwest Corporation
Multi-Stage DCF Estimates
Non-Telcos

| | [A] | [B] | [C] | [D] | [E] | [F] | [G] | [H] |
|---|---|---|---|---|---|---|---|---|
| Line No. | | Current Mkt. Price ($P_o$) | Projected Dividends[1] (stage 1 growth) ($D_t$) | | | | Stage 2 growth[2] ($g_n$) | Equity Cost Estimate ($K$) |
| | | | $d_1$ | $d_2$ | $d_3$ | $d_4$ | | |
| 1 | Abbot Labs | 40.6 | 1.04 | 1.11 | 1.19 | 1.28 | 6.5% | 9.1% |
| 2 | AFLAC | 39.5 | 0.38 | 0.42 | 0.47 | 0.52 | 6.5% | 7.5% |
| 3 | Air Products | 52.0 | 1.16 | 1.21 | 1.26 | 1.32 | 6.5% | 8.6% |
| 4 | Anheuser Busch | 53.1 | 0.98 | 1.01 | 1.04 | 1.08 | 6.5% | 8.2% |
| 5 | Auto. Data Proc. | 40.1 | 0.56 | 0.60 | 0.65 | 0.70 | 6.5% | 7.9% |
| 6 | Barrick Gold | 19.3 | 0.22 | 0.23 | 0.23 | 0.24 | 6.5% | 7.4% |
| 7 | Brown-Forman | 45.9 | 0.85 | 0.88 | 0.92 | 0.95 | 6.5% | 8.2% |
| 8 | California Water | 27.5 | 1.13 | 1.15 | 1.16 | 1.18 | 6.5% | 10.1% |
| 9 | Coca-Cola | 44.6 | 1.06 | 1.15 | 1.25 | 1.36 | 6.5% | 9.0% |
| 10 | Colgate-Palmolive | 52.1 | 0.96 | 1.03 | 1.11 | 1.20 | 6.5% | 8.4% |
| 11 | Danaher Corp. | 50.2 | 0.06 | 0.07 | 0.07 | 0.08 | 6.5% | 5.6% |
| 12 | Ecolab Inc. | 30.3 | 0.33 | 0.36 | 0.39 | 0.42 | 6.5% | 7.6% |
| 13 | Emerson Electric | 62.4 | 1.60 | 1.64 | 1.68 | 1.72 | 6.5% | 8.8% |
| 14 | E.W. Scripps | 101.2 | 0.80 | 0.87 | 0.94 | 1.01 | 6.5% | 7.1% |
| 15 | Gillette | 40.9 | 0.65 | 0.67 | 0.69 | 0.71 | 6.5% | 7.9% |
| 16 | Illinois Tool Works | 91.0 | 1.04 | 1.10 | 1.16 | 1.22 | 6.5% | 7.5% |
| 17 | Johnson & Johnson | 57.0 | 1.14 | 1.25 | 1.36 | 1.49 | 6.5% | 8.6% |
| 18 | Legget & Platt | 27.4 | 0.60 | 0.63 | 0.65 | 0.68 | 6.5% | 8.6% |
| 19 | McDonald's Corp. | 26.5 | 0.44 | 0.45 | 0.47 | 0.48 | 6.5% | 8.0% |
| 20 | MGIC Investment | 68.5 | 0.30 | 0.33 | 0.36 | 0.40 | 6.5% | 6.6% |
| 21 | Sherwin-Williams | 39.9 | 0.72 | 0.79 | 0.86 | 0.95 | 6.5% | 8.4% |
| 22 | UnitedHealth Grp. | 65.1 | 0.03 | 0.04 | 0.05 | 0.06 | 6.5% | 5.3% |
| 23 | UST Inc. | 38.8 | 2.12 | 2.16 | 2.21 | 2.26 | 6.5% | 11.4% |
| 24 | Vulcan Materials | 47.7 | 1.04 | 1.09 | 1.15 | 1.20 | 6.5% | 8.6% |
| 25 | WPS Resources | 47.7 | 2.22 | 2.26 | 2.30 | 2.34 | 6.5% | 10.6% |
| 26 | | | | | | | Average | 8.2% |

$$P_0 = \sum_{t=1}^{n} \frac{D_t}{(1+K)^t} + \frac{D_n(1+g_n)}{K-g_n}\left[\frac{1}{(1+K)}\right]^n$$

Where: $P_0$ = current stock price
$D_t$ = dividends expected during stage 1
$K$ = cost of equity
$n$ = years of non – constant growth
$D_n$ = dividend expected in year n
$g_n$ = constant rate of growth expected after year n

44 [1] $d_1$ = "Est'd Div'd next 12 mos." 08/13/2004, *Value Line* Summary & Index.
45 [2] Average annual growth in GDP 1929 - 2003 in current dollars. http://www.bea.doc.gov/

Qwest Corporation
Calculation of Unlevered Beta
Non-Telcos

$$\beta_{UL} = \frac{\beta_L}{1 + BD + EC\,(1 - t)}$$

Where :

$\beta_{UL}$ = unlevered beta
$\beta_L$ = levered beta
$BD$ = book debt
$EC$ = equity capital
$t$ = tax rate

| Line No. | [A] | [B] Value Line Levered Raw Beta $\beta_L$ | [C] Merrill Lynch Levered Raw Beta $\beta_L$ | [D] Average Merrill Lynch & Value Line Raw Beta $\beta_{raw}$ | [E] Tax Rate t | [F] Book Debt BD | [G] Equity Cap EC | [H] Value Line Unlevered Raw Beta $\beta_{UL}$ | [I] Merrill Lynch Unlevered Raw Beta $\beta_{UL}$ | [J] Average Merrill Lynch & Value Line Unlevered Raw Beta $\beta_{UL}$ |
|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Abbot Labs | 0.67 | 0.29 | 0.48 | 25.0% | 0.33 | 0.67 | 0.49 | 0.21 | 0.35 |
| 2 | AFLAC | 0.90 | 0.55 | 0.72 | 35.0% | 0.17 | 0.83 | 0.79 | 0.48 | 0.64 |
| 3 | Air Products | 0.90 | 0.85 | 0.87 | 27.5% | 0.40 | 0.60 | 0.60 | 0.57 | 0.58 |
| 4 | Anheuser Busch | 0.37 | -0.10 | 0.14 | 38.0% | 0.72 | 0.28 | 0.14 | -0.04 | 0.05 |
| 5 | Auto. Data Proc. | 0.90 | 1.09 | 0.99 | 39.5% | 0.02 | 0.98 | 0.89 | 1.08 | 0.98 |
| 6 | Barrick Gold | 0.15 | n/a | 0.15 | 30.0% | 0.18 | 0.82 | 0.13 | n/a | 0.13 |
| 7 | Brown-Forman | 0.45 | n/a | 0.45 | 34.0% | 0.37 | 0.63 | 0.32 | n/a | 0.32 |
| 8 | California Water | 0.52 | n/a | 0.52 | 40.0% | 0.53 | 0.47 | 0.31 | n/a | 0.31 |
| 9 | Coca-Cola | 0.45 | 0.29 | 0.37 | 24.5% | 0.31 | 0.69 | 0.33 | 0.22 | 0.28 |
| 10 | Colgate-Palmolive | 0.52 | 0.47 | 0.50 | 32.0% | 0.89 | 0.11 | 0.08 | 0.07 | 0.08 |
| 11 | Danaher Corp. | 0.97 | 0.85 | 0.91 | 31.5% | 0.25 | 0.75 | 0.79 | 0.69 | 0.74 |
| 12 | Ecolab Inc. | 0.82 | 0.64 | 0.73 | 37.0% | 0.37 | 0.63 | 0.60 | 0.46 | 0.53 |
| 13 | Emerson Electric | 1.04 | 0.92 | 0.98 | 32.0% | 0.39 | 0.61 | 0.73 | 0.64 | 0.68 |
| 14 | E.W. Scripps | 0.82 | 0.52 | 0.67 | 37.0% | 0.20 | 0.80 | 0.71 | 0.45 | 0.58 |
| 15 | Gillette | 0.45 | 0.25 | 0.35 | 29.0% | 0.58 | 0.42 | 0.23 | 0.12 | 0.18 |
| 16 | Illinois Tool Works | 0.97 | 0.86 | 0.92 | 34.0% | 0.11 | 0.89 | 0.90 | 0.80 | 0.85 |
| 17 | Johnson & Johnson | 0.52 | 0.26 | 0.39 | 28.5% | 0.11 | 0.89 | 0.48 | 0.24 | 0.36 |
| 18 | Legget & Platt | 1.04 | 1.03 | 1.04 | 36.0% | 0.35 | 0.65 | 0.78 | 0.77 | 0.77 |
| 19 | McDonald's Corp. | 1.04 | 0.79 | 0.92 | 33.0% | 0.44 | 0.56 | 0.68 | 0.51 | 0.60 |
| 20 | MGIC Investment | 1.19 | 1.02 | 1.10 | 30.0% | 0.13 | 0.87 | 1.08 | 0.92 | 1.00 |
| 21 | Sherwin-Williams | 0.97 | 0.71 | 0.84 | 35.5% | 0.26 | 0.74 | 0.79 | 0.58 | 0.69 |
| 22 | UnitedHealth Grp. | 0.45 | 0.31 | 0.38 | 35.0% | 0.28 | 0.72 | 0.36 | 0.24 | 0.30 |
| 23 | UST Inc. | 0.82 | 0.37 | 0.59 | 38.5% | 0.99 | 0.01 | 0.02 | 0.01 | 0.01 |
| 24 | Vulcan Materials | 1.04 | 0.74 | 0.89 | 31.0% | 0.32 | 0.68 | 0.79 | 0.56 | 0.67 |
| 25 | WPS Resources | 0.60 | n/a | 0.60 | 26.0% | 0.47 | 0.53 | 0.36 | n/a | 0.36 |
| 26 | | | | | | | | | | |
| 27 | | | | | | | | | | |
| 28 | Company Sample | 0.74 | 0.60 | 0.66 | 33% | 0.37 | 0.63 | 0.54 | 0.46 | 0.48 |
| 29 | | | | | | | | | | |
| 30 | | | | | | | | | | |
| 31 | | | | | | | | | | |
| 32 | | | | | | | | | | |
| 33 | Tax Rate: Value Line | | | | | | | | | |
| 34 | Supporting Schedules: JR-15 JR-18 | | | | | | | | | |

Schedule JR-21

Qwest Corporation
Docket T-01051B-03-0454

Qwest Corporation
Calculation of Relevered Beta
Non-Telcos

$$\beta_{RL} = \beta_{UL}\ (1 + (1 - t)BD + EC)$$

Where :
$\beta_{RL}$ = relevered beta
$\beta_{UL}$ = unlevered beta
$t$ = tax rate
$BD$ = book debt
$EC$ = equity capital

| Line No. | [A] | [B] Value Line Unlevered Raw Beta $\beta_{UL}$ | [C] Merrill Lynch Unlevered Raw Beta $\beta_{UL}$ | [D] Book Debt BD | [E] Equity Cap EC | [F] Tax Rate t | [G] Value Line Relevered Raw Beta $\beta_{RL}$ | [H] Value Line Adjusted Relevered Beta .35 + .67(Raw Beta) $\beta_{RL}$ | [I] Merrill Lynch Relevered Raw Beta $\beta_{RL}$ | [J] Merrill Lynch Adjusted Relevered Beta .34 + .66(Raw Beta) $\beta_{RL}$ | [K] Average Value Line & Merrill Lynch Adjusted Relevered Beta |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Qwest Corporation | 0.54 | 0.46 | 0.75 | 0.25 | 38.3% | 1.54 | 1.38 | 1.31 | 1.21 | 1.29 |
| 2 | | | | | | | | | | | |
| 3 | | | | | | | | | | | |
| 4 | | | | | | | | | | | |
| 5 | | | | | | | | | | | |
| 6 | | | | | | | | | | | |
| 7 | | | | | | | | | | | |
| 8 | Tax Rate: Company Application Schedule C-3 | | | | | | | | | | |
| 9 | Supporting Schedules: JR-21 | | | | | | | | | | |

Schedule JR-22

Qwest Corporation
Required Capital Structure Adjustment
Non-Telcos

| Line No. | [A] | [B] | | [C] | | [D] |
|---|---|---|---|---|---|---|
| | **Non-Telcos Average Levered Beta** | $\beta$ | **x** | **(Rp)** | **=** | **[β × Rp]** |
| 1 | Historical Market Risk Premium | 0.79 | x | 7.6% | = | 6.0% |
| 2 | Current Market Risk Premium | 0.79 | x | 8.2% | = | 6.5% |
| 3 | **Average [β × Rp]** | | | | | **6.2%** |
| 4 | | | | | | |
| 5 | **Qwest Corp. Relevered Beta** | $\beta$ | | **(Rp)** | | **[β × Rp]** |
| 6 | Historical Market Risk Premium | 1.29 | x | 7.6% | = | 9.8% |
| 7 | Current Market Risk Premium | 1.29 | x | 8.2% | = | 10.6% |
| 8 | **Average [β × Rp]** | | | | | **10.2%** |
| 9 | | | | | | |
| 10 | Capital Structure Adjustment (8 - 3) | | | | | 4.0% |
| 11 | | | | | | |
| 12 | | | | | | |
| 13 | | | | | | |
| 14 | | | | | | |
| 15 | Supporting Schedules: JR-14, JR-22 | | | | | |

Schedule JR-23

Qwest Corporation
Docket No. T-01051B-03-0454

Schedule JR-24

# Qwest Corporation
## Corrections to Mr. Cummings' Capital Structure/Financial Risk Adjustment

| | [A] | [B] | [C] | [D] | [E] | [F] | [G] | [H] | [I] | [J] | [K] | [L] | [M] | [N] | [O] | [P] | [Q] | [R] | [S] | [T] | [U] |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Levered Beta | | | | | | Capital Structure | | | | Unlevered Beta | | | | Relevered Beta | | | | | | |
| | Adjusted Beta | | | Raw (de-adjusted) Beta | | | | | | | Adjusted | Raw (de-adjusted) Beta | | | Adjusted | Raw (de-adjusted) Beta | | | Re-adjusted Beta | | |
| | $ML_{adj}$ Published | $VL_{adj}$ Published | $Avg_{adj}$ | $ML_{raw}$ ([A]-.34)/.66 | $VL_{raw}$ ([B]-.35)/.67 | $Avg_{raw}$ | $ Equity | $ Debt | % Debt | % Equity | $Avg_{adj}$ | $ML_{raw}$ | $VL_{raw}$ | $Avg_{raw}$ | $Avg_{adj}$ | $ML_{raw}$ | $VL_{raw}$ | $Avg_{raw}$ | ML ([P]x.66)+.34 | VL ([Q]x.67)+.35 | Avg |
| **Telephone Companies** | | | | | | | (millions) | (millions) | | | | | | | | | | | | | |
| 1 BellSouth | 0.98 | 0.95 | 0.97 | 0.97 | 0.90 | 0.93 | 20,410 | 13,124 | 39.1% | 60.9% | 0.68 | 0.68 | 0.63 | 0.66 | 1.95 | 1.96 | 1.81 | 1.89 | 1.64 | 1.56 | 1.60 |
| 2 SBC Communications | 0.88 | 1.05 | 0.97 | 0.82 | 1.04 | 0.93 | 38,444 | 17,924 | 31.8% | 68.2% | 0.74 | 0.63 | 0.80 | 0.72 | 2.13 | 1.80 | 2.30 | 2.05 | 1.53 | 1.89 | 1.71 |
| 3 Verizon | 0.98 | 1.00 | 0.99 | 0.97 | 0.97 | 0.97 | 33,894 | 44,452 | 56.7% | 43.3% | 0.53 | 0.52 | 0.52 | 0.52 | 1.53 | 1.50 | 1.50 | 1.50 | 1.33 | 1.36 | 1.35 |
| 4 ALLTEL Corp | 0.88 | 1.00 | 0.94 | 0.82 | 0.97 | 0.89 | 7,037 | 5,885 | 45.5% | 54.5% | 0.61 | 0.53 | 0.63 | 0.58 | 1.75 | 1.52 | 1.80 | 1.66 | 1.35 | 1.56 | 1.45 |
| 5 CenturyTel Inc | 0.92 | 1.10 | 1.01 | 0.88 | 1.12 | 1.00 | 3,438 | 3,089 | 47.3% | 52.7% | 0.64 | 0.56 | 0.71 | 0.63 | 1.83 | 1.59 | 2.03 | 1.81 | 1.39 | 1.71 | 1.55 |
| 6 Citizens Comm Company | 1.25 | 1.05 | 1.15 | 1.38 | 1.04 | 1.21 | 1,453 | 4,409 | 75.2% | 24.8% | 0.39 | 0.46 | 0.35 | 0.41 | 1.11 | 1.33 | 1.01 | 1.17 | 1.22 | 1.03 | 1.12 |
| 7 | | | | | | | | | | | | | | | | | | | | | |
| 8 **Average** | 0.98 | 1.03 | 1.00 | 0.97 | 1.01 | 0.99 | | | 49.3% | 50.7% | 0.60 | 0.56 | 0.61 | 0.59 | 1.72 | 1.62 | 1.74 | 1.68 | 1.41 | 1.52 | 1.46 |
| 9 | | | | | | | | | | | | | | | | | | | | | |
| 10 **Comparable Companies** | | | | | | | | | | | | | | | | | | | | | |
| 11 Abbott Laboratories | 0.53 | 0.80 | 0.67 | 0.29 | 0.67 | 0.48 | 13,498 | 6,640 | 33.0% | 67.0% | 0.50 | 0.22 | 0.51 | 0.36 | 1.45 | 0.63 | 1.46 | 1.05 | 0.76 | 1.33 | 1.04 |
| 12 AFLAC Inc | 0.70 | 0.95 | 0.83 | 0.55 | 0.90 | 0.72 | 6,825 | 1,423 | 17.3% | 82.7% | 0.73 | 0.48 | 0.79 | 0.64 | 2.09 | 1.38 | 2.26 | 1.82 | 1.25 | 1.87 | 1.56 |
| 13 Air Products & Chemicals | 0.90 | 1.00 | 0.95 | 0.85 | 0.97 | 0.91 | 3,782 | 2,572 | 40.5% | 59.5% | 0.66 | 0.59 | 0.67 | 0.63 | 1.89 | 1.69 | 1.93 | 1.81 | 1.46 | 1.64 | 1.55 |
| 14 Anheuser Busch Cos Inc | 0.27 | 0.60 | 0.44 | -0.10 | 0.37 | 0.14 | 2,912 | 7,532 | 72.1% | 27.9% | 0.16 | -0.04 | 0.14 | 0.05 | 0.47 | -0.11 | 0.40 | 0.15 | 0.27 | 0.62 | 0.44 |
| 15 Automatic Data Processing | 1.06 | 0.95 | 1.01 | 1.09 | 0.90 | 0.99 | 5,371 | 85 | 1.6% | 98.4% | 0.99 | 1.08 | 0.89 | 0.98 | 2.86 | 3.10 | 2.54 | 2.82 | 2.39 | 2.06 | 2.22 |
| 16 Barrick Gold Corp | | 0.45 | 0.45 | | 0.15 | 0.15 | 3,491 | 762 | 17.9% | 82.1% | 0.39 | | 0.13 | 0.13 | 1.13 | | 0.38 | 0.38 | | 0.60 | 0.60 |
| 17 Brown-Forman Cl B | | 0.65 | 0.65 | | 0.45 | 0.45 | 1,145 | 680 | 37.2% | 62.8% | 0.47 | | 0.32 | 0.32 | 1.35 | | 0.93 | 0.93 | | 0.97 | 0.97 |
| 18 California Water Service | | 0.65 | 0.65 | | 0.45 | 0.45 | 253 | 283 | 52.7% | 47.3% | 0.38 | | 0.26 | 0.26 | 1.08 | | 0.74 | 0.74 | | 0.85 | 0.85 |
| 19 Coca Cola Co | 0.53 | 0.65 | 0.59 | 0.29 | 0.45 | 0.37 | 14,576 | 6,552 | 31.0% | 69.0% | 0.46 | 0.22 | 0.35 | 0.29 | 1.31 | 0.65 | 0.99 | 0.82 | 0.77 | 1.02 | 0.89 |
| 20 Colgate-Palmolive Co | 0.65 | 0.70 | 0.68 | 0.47 | 0.52 | 0.50 | 384 | 3,115 | 89.0% | 11.0% | 0.11 | 0.08 | 0.08 | 0.08 | 0.31 | 0.22 | 0.24 | 0.23 | 0.48 | 0.51 | 0.50 |
| 21 Danaher Corp | 0.90 | 1.05 | 0.98 | 0.85 | 1.04 | 0.95 | 3,961 | 1,301 | 24.7% | 75.3% | 0.80 | 0.70 | 0.86 | 0.78 | 2.31 | 2.01 | 2.47 | 2.24 | 1.67 | 2.01 | 1.84 |
| 22 Deluxe Corp | | | | | | | | | | | | | | | | | | | | | |
| 23 Ecolab Inc | 0.76 | 0.90 | 0.83 | 0.64 | 0.82 | 0.73 | 1,331 | 791 | 37.3% | 62.7% | 0.60 | 0.46 | 0.59 | 0.53 | 1.72 | 1.32 | 1.70 | 1.51 | 1.21 | 1.49 | 1.35 |
| 24 Emerson Electric | 0.95 | 1.05 | 1.00 | 0.92 | 1.04 | 0.98 | 6,617 | 4,260 | 39.2% | 60.8% | 0.70 | 0.65 | 0.74 | 0.69 | 2.02 | 1.87 | 2.11 | 1.99 | 1.58 | 1.77 | 1.67 |
| 25 E W Scripps - CL A | 0.68 | 0.90 | 0.79 | 0.52 | 0.82 | 0.67 | 1,884 | 458 | 19.6% | 80.4% | 0.68 | 0.45 | 0.71 | 0.58 | 1.96 | 1.28 | 2.04 | 1.66 | 1.19 | 1.71 | 1.45 |
| 26 Gillette Co | 0.50 | 0.65 | 0.58 | 0.25 | 0.45 | 0.35 | 2,244 | 3,050 | 57.6% | 42.4% | 0.31 | 0.13 | 0.24 | 0.18 | 0.88 | 0.37 | 0.68 | 0.53 | 0.59 | 0.81 | 0.70 |
| 27 Illinois Tool Works | 0.91 | 1.00 | 0.96 | 0.86 | 0.97 | 0.92 | 7,896 | 972 | 11.0% | 89.0% | 0.88 | 0.80 | 0.90 | 0.85 | 2.54 | 2.30 | 2.58 | 2.44 | 1.86 | 2.08 | 1.97 |
| 28 Johnson & Johnson | 0.51 | 0.70 | 0.61 | 0.26 | 0.52 | 0.39 | 27,837 | 3,555 | 11.3% | 88.7% | 0.56 | 0.24 | 0.48 | 0.36 | 1.60 | 0.69 | 1.38 | 1.04 | 0.79 | 1.28 | 1.04 |
| 29 Leggett & Platt Inc | 1.02 | 1.05 | 1.04 | 1.03 | 1.04 | 1.04 | 2,132 | 1,128 | 34.6% | 65.4% | 0.77 | 0.77 | 0.78 | 0.77 | 2.21 | 2.20 | 2.23 | 2.22 | 1.80 | 1.85 | 1.82 |
| 30 McDonalds Corp | 0.86 | 1.00 | 0.93 | 0.79 | 0.97 | 0.88 | 12,266 | 9,749 | 44.3% | 55.7% | 0.61 | 0.52 | 0.64 | 0.58 | 1.76 | 1.49 | 1.84 | 1.66 | 1.33 | 1.58 | 1.45 |
| 31 MGIC Investment Corp | 1.01 | 1.20 | 1.11 | 1.02 | 1.27 | 1.14 | 3,896 | 600 | 13.3% | 86.7% | 1.00 | 0.92 | 1.15 | 1.04 | 2.88 | 2.65 | 3.31 | 2.98 | 2.09 | 2.57 | 2.33 |
| 32 Middlesex Water Co | | | | | | | | | | | | | | | | | | | | | |
| 33 Sherwin-Williams Co | 0.81 | 1.00 | 0.91 | 0.71 | 0.97 | 0.84 | 1,493 | 514 | 25.6% | 74.4% | 0.74 | 0.58 | 0.79 | 0.69 | 2.12 | 1.67 | 2.28 | 1.97 | 1.45 | 1.88 | 1.66 |
| 34 UnitedHealth Group Inc | 0.54 | 0.65 | 0.60 | 0.31 | 0.45 | 0.38 | 6,198 | 2,400 | 27.9% | 72.1% | 0.48 | 0.24 | 0.36 | 0.30 | 1.36 | 0.70 | 1.03 | 0.86 | 0.80 | 1.04 | 0.92 |
| 35 UST Inc | 0.58 | 0.85 | 0.72 | 0.37 | 0.75 | 0.56 | 16 | 1,140 | 98.6% | 1.4% | 0.01 | 0.01 | 0.02 | 0.01 | 0.04 | 0.02 | 0.04 | 0.03 | 0.35 | 0.38 | 0.37 |
| 36 Vulcan Materials | 0.83 | 1.00 | 0.92 | 0.74 | 0.97 | 0.86 | 1,837 | 881 | 32.4% | 67.6% | 0.70 | 0.57 | 0.74 | 0.65 | 2.00 | 1.63 | 2.12 | 1.88 | 1.42 | 1.77 | 1.59 |
| 37 WPS Resources Corp | | 0.75 | 0.75 | | 0.60 | 0.60 | 1,018 | 888 | 46.6% | 53.4% | 0.48 | | 0.38 | 0.38 | 1.37 | | 1.09 | 1.09 | | 1.08 | 1.08 |
| 38 | | | | | | | | | | | | | | | | | | | | | |
| 39 **Average** | 0.74 | 0.85 | 0.78 | 0.60 | 0.74 | 0.66 | | | 36.7% | 63.3% | 0.57 | 0.46 | 0.54 | 0.49 | 1.63 | 1.32 | 1.55 | 1.39 | 1.21 | 1.39 | 1.27 |
| 40 | | | | | | | | | | | | | | | | | | | | | |
| 41 **Average Telephone & Comparable Cos.** | 0.86 | 0.94 | 0.89 | 0.79 | 0.87 | 0.82 | | | | | 0.58 | 0.51 | 0.57 | 0.54 | 1.67 | 1.47 | 1.65 | 1.54 | 1.31 | 1.45 | 1.37 |

Source: Direct testimony of Peter C. Cummings Exhibit PCC-3
Value Line
Direct testimony of Joel M. Reiker Schedules JR-10 & JR-11
Deluxe Corp eliminated due to negative equity
Middlesex Water Co. eliminated because it is not followed by Value Line

Schedule JR-24

# RAMIZER

**BEFORE THE ARIZONA CORPORATION COMMISSION**

MARC SPITZER
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN MAYES
Commissioner

| | |
|---|---|
| IN THE MATTER OF QWEST CORPORATION'S FILING AMENDED RENEWED PRICE REGULATION PLAN | DOCKET NO. T-01051B-03-0454 |
| IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS | DOCKET NO. T-00000D-00-0672 |

DIRECT

TESTIMONY

OF

ALEJANDRO RAMIREZ

PUBLIC UTILITIES ANALYST I

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

NOVEMBER 18, 2004

## TABLE OF CONTENTS



## SCHEDULES



## EXHIBITS

## EXECUTIVE SUMMARY

The direct testimony of Staff witness Alejandro Ramirez addresses the following issues:

Capital Structure – Staff recommends that the Commission adopt Qwest Corporation's actual end of test year 2003 capital structure consisting of 75.2 percent debt and 24.8 percent equity.

Cost of debt – Staff recommends that the Commission adopt Qwest Corporation's actual end of test year 2003 cost of outstanding debt of 7.81 percent.

Overall Rate of Return - Staff recommends that the Commission adopt 9.5 percent for the overall rate of return ("ROR") to establish the revenue requirement for Qwest Corporation.

**INTRODUCTION**

**Q. Please state your name, occupation, and business address.**

A. My name is Alejandro Ramirez. I am a Public Utilities Analyst employed by the Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

**Q. Briefly describe your responsibilities as a Public Utilities Analyst.**

A. In my position as a Public Utilities Analyst, I perform studies to estimate the cost of capital component of the revenue requirement in rate proceedings. I also perform other financial analyses.

**Q. Please describe your educational background and professional experience.**

A. In 2002, I graduated summa cum laude from Arizona State University, receiving a Bachelor of Science degree in Global Business with a specialization in finance. While attending Arizona State University, I successfully completed the Barrett Honors College curriculum. My course of studies included classes in corporate and international finance, investments, accounting, statistics, and economics. I began employment as a Staff Public Utilities Analyst in 2003. Since that time, I have provided recommendations to the Commission on financings and prepared various studies in the field of cost of capital and econometrics. I have also attended seminars related to general regulatory and business issues.

**Q. What is the scope of your testimony in this case?**

A. I provide Staff's recommended capital structure, cost of debt and rate of return in this proceeding. I discuss the appropriate overall rate of return ("ROR") for establishing the revenue requirement for Qwest Corporation. ("QC" or "Applicant").

**SUMMARY OF TESTIMONY AND RECOMMENDATIONS**

**Q. Briefly summarize how Staff's cost of capital testimony is organized.**

A. Staff's cost of capital testimony is organized in four sections. Section I discusses the concept of weighted average cost of capital ("WACC"). Section II presents the concept of capital structure and Staff's recommended capital structure for QC in this proceeding. Section III presents Staff's recommended cost of debt for the Applicant. Finally, Section IV presents Staff's overall rate of return recommendation for the Applicant.

**Q. Have you prepared any exhibits to your testimony?**

A. Yes. I prepared five schedules (AXR-1 to AXR-5) that support Staff's cost of capital analysis.

**Q. What is Staff's recommended overall rate of return for Qwest Corporation?**

A. Staff recommends a 9.5 percent ROR. Staff's recommendation is based on its cost of equity estimate of 14.6 percent and the Applicant's actual end of test year cost of debt of 7.81 percent. The ROR calculation is presented on Schedule AXR-1.

**I. THE WEIGHTED AVERAGE COST OF CAPITAL**

**Q. Please define the cost of capital concept.**

A. The cost of capital is the opportunity cost of the funds employed as the result of an investment decision. The cost of capital represents the returns that could be expected to be earned in other investments with equivalent risk. In other words, the cost of capital is the return that stakeholders expect for committing their resources in a determined business enterprise. The cost of capital is calculated as the weighted average cost of capital("WACC").

**Q. How is the WACC for utilities calculated?**

**A.** The WACC is calculated by adding the weighted expected return on equity and the weighted embedded cost of debt.

The following equation shows how the WACC is calculated:

Equation 1.

$$WACC = W_{debt} * r_{debt} + W_{equity} r_{equity}$$

Where $W_{debt}$ and $W_{equity}$ are the weights given to the Applicant's securities (the proportion of the each security relative to the portfolio), $r_{debt}$ is the embedded cost of debt and $r_{equity}$ is the expected return on equity.

**Q. Can you explain Equation 1?**

**A.** Let's assume that a firm has a capital structure composed of 75 percent debt and 25 percent equity. Let's also assume that the embedded cost of debt is 7.8 percent and the expected return on equity (cost of equity) is 10.5 percent. The WACC calculation is as follows:

WACC = (75% * 7.8%) + (25% * 10.5%)

WACC = 5.85% + 2.63%

WACC = 8.48%

The weighted average cost of capital in this example is 8.48 percent. Given the example firm's capital structure, the company would have to earn an overall rate of return of 8.48 percent to cover its cost of capital.

## II. CAPITAL STRUCTURE

**Background**

**Q. Please briefly explain the capital structure concept.**

A. The capital structure of a firm shows how its assets are financed over the long-run. The capital structure of a firm is the mix of capital leases, long-term debt, preferred stock and common stock that are used to finance the firm's assets.

**Q. How is the capital structure calculated?**

A. The capital structure of a company is calculated by finding the percentage of each component of the capital structure (capital leases, long-term debt, preferred stock and common stock) relative to the total capital (the total sum of all the components of the capital structure).

For illustrative purposes, let's suppose that company A is financed by $15,000 of capital leases, $80,000 of long-term debt, $5,000 of preferred stock and $35,000 of common stock. Company A's capital structure would be calculated as follows:

Table 1.

| Component | | | % |
|---|---|---|---|
| Capital Leases | $15,000 | ($15,000/$135,000) | 11.1% |
| Long-Term Debt | $80,000 | ($80,000/$135,000) | 59.3% |
| Preferred Stock | $5,000 | ($5,000/$135,000) | 3.7% |
| Common Stock | $35,000 | ($35,000/$135,000) | 25.9% |
| Total | $135,000 | | 100% |

In this example, Company A's capital structure is composed of 11.1 percent capital leases, 59.3 percent long-term debt, 3.7 percent preferred stock and 25.9 percent common stock.

**Qwest Corporation Capital Structure**

**Q. What capital structure does the Applicant propose for its Arizona operations?**

A. QC proposes in this proceeding a capital structure composed of 75.17 percent debt and 24.83 percent common equity. Schedule AXR-1 shows QC's proposed capital structure in this proceeding.

**Q. How did the Applicant calculate the proposed capital structure?**

A. The Applicant calculated the value of components of its Arizona capital structure based on regulatory and accounting records prescribed by the Federal Communication Commission ("FCC") allocated among jurisdictions on the basis of net plant in service.

**Q. Would the Applicant's proposed capital structure change if the net plant in service for Arizona versus other jurisdictions changes?**

A. No. A change in the relative percentage of net plant in the Arizona jurisdiction would change the dollar value of the capital components; however, the proportion of each component would remain the same.

For illustrative purposes, let's go back to the example of Company A, which as previously stated, is financed by $15,000 of capital leases, $80,000 of long-term debt, $5,000 of preferred stock and $35,000 of common stock. Assuming two net plant scenarios (10 percent and 16 percent) for Company A's operations in a region. Table 2 summarizes the results:

Table 2.

| | 10 % Allocation Factor | | 16 % Allocation Factor | |
|---|---|---|---|---|
| Component | Dollar Amount | % | Dollar Amount | % |
| Capital Leases | $1,500 | 11.1% | $2,400 | 11.1% |
| Long-Term Debt | $8,000 | 59.3% | $12,800 | 59.3% |
| Preferred Stock | $500 | 3.7% | $800 | 3.7% |
| Common Stock | $3,500 | 25.9% | $5,600 | 25.9% |
| Total | $13,500 | 100% | $21,600 | 100% |

As shown in Table 2, changes in the allocation factor (net plant) do not change the proportion of the financial instruments included in the capital structure.

**Q. How does QC's capital structure compare to other telephone companies?**

A. Schedule AXR-2 shows a comparison between a Sample of Telecos (the sample used by Staff witness Mr. Reiker), QC and Qwest International (Holding Company of QC). The average capital structure for the sample Telecos is composed of 47.8 percent debt and 52.2 percent equity. In contrast, QC's capital structure is composed of 75.2 percent debt and 24.8 percent equity. QC's capital structure is more leveraged than the average capital structure of the sample Telecos. Qwest International, QC's holding company, currently has negative equity.

**Q. Does Staff have any concerns regarding QC's capital structure?**

A. Yes. Staff is concerned with QC's current capital structure and its implication for the future. As stated above, QC's current capital structure is more leveraged than the sample telecos. Moreover, Staff is concerned with QC's new dividend policy that was established in July 2004.

**Q. What is QC's new dividend policy?**

A. QC's new dividend policy allows QC to consistently declare dividends in excess of its earnings. The following is an excerpt found in QC's 10-Q[1] for the period ending June 30, 2004, page 24:

> "In July 2004, we [Qwest Corporation] modified our dividend practice to balance our financial needs, cash position and credit profile with those of our parent. As a result, going forward, we may declare and pay dividends in excess of our earnings."

**Q. How could this new dividend policy affect QC's overall financial condition?**

A. If QC consistently declares dividends in excess of its earnings, QC's book equity may be further reduced, resulting in an even more leveraged capital structure. QC's bond rating and its cost of debt may be adversely affected by an increase in leverage.

**Q. Does staff believe that the Applicant's actual capital structure should be adopted for rate-making purposes in this case?**

A. Yes.

## III. COST OF DEBT

**Q. Are the applicant's debt instruments graded by credit rating agencies?**

A. Yes. Schedule AXR-3 shows QC's long-term debt rating from the three main credit rating agencies: Standard & Poor's ("S&P"), Moody's Investors Services (Moody's) and Fitch Ratings ("Fitch") at June 30, 2004 and at December 31, 2003. Investment grade bonds are those whose investment grade is at least BBB- (S&P), Baa3 (Moody's) and BBB- (Fitch). QC's long-term debt grade at December 31, 2003 was B- (S&P), Ba3 (Moody's) and B (Fitch). QC's long-term debt grade at June 30, 2004 was BB- (S&P), Ba3 (Moody's) and

[1] See Exhibit 1: *Note 8: Subsequent Events*. Taken from QC's 10-Q filed on August 06, 2004.

BB (Fitch). Even though QC's long-term debt grade has improved since December 31, 2003, it is still regarded as speculative.

**Q. How does QC's long-term debt rating compare to the sample Telecos previously referred to in this testimony?**

A. Schedule AXR-4 shows S&P and Moody's bond grades for the sample Telecos. With the exception of Citizens Communications, the sample Telecos have an investment grade (At least BBB- in S&P and Baa3 in Moody's) rating.

**Q. Is Staff concerned with QC's long-term debt grade?**

**A.** Yes, it is. As shown in Schedule AXR-3, QC's long-term debt grade is still below the investment grade. In addition, QC's credit rating could be negatively affected by Qwest International Communications, Inc. financial position. The following is an excerpt found in QC's 10-Q for the period ending June 30, 2004, page 37:

> "...if cash provided by our and QCII's [Qwest Communications International, Inc] operations does not improve, if competitive pressures increase, if revenue and cash provided by operations continue to decline, if economic conditions weaken or if we [Qwest Corporation] or QCII become subject to significant judgments..."
>
> "We or QCII could be required to make significant payments that we do not have the resources to make."
>
> "...QCII's ability to meet its debt service obligations and its financial condition could be materially and adversely affected, potentially adversely affect its credit ratings, its ability to access the capital markets and its compliance with debt covenants."
>
> "*As a wholly owned subsidiary of QCII, our business operations and financial condition could also be affected, potentially impacting our credit ratings and access to capital markets* [emphasis added]."

**Q. What is the implication of QC's lower debt rating compared to the sample Telecos?**

**A.** A lower debt rating translates into higher debt costs for new issuances resulting in higher cost of service that may be passed on to ratepayers.

**Q. What cost of debt does the Applicant propose?**

**A.** The Applicant proposes 7.81 percent as the cost of debt (for practical purposes, capital leases are included in the long-term portion). Schedule AXR-5 summarizes QC's cost of debt.

**Q. Does Staff agree with the cost of debt that QC proposes?**

**A.** Yes, Staff agrees with QC's proposed cost of debt of 7.81 percent.

## IV. RATE OF RETURN RECOMMENDATION

**Q. What is Staff's overall rate of return recommendation for Qwest Corporation?**

A. Based on the cost of equity recommendation of 14.6 percent presented by Staff witness Mr. Reiker, Staff recommends a ROR of 9.5 percent for the Applicant, as shown in Schedule AXR-1 and the following table:

**Table 3**

| | Weight | Cost | Weighted Cost |
|---|---|---|---|
| Long-term Debt | 75.2% | 7.81% | 5.87% |
| Common Equity | 24.8% | 14.6% | 3.63% |
| **Cost of Capital/ROR** | | | **9.5%** |

**CONCLUSION**

**Q. Please summarize Staff's recommendations.**

A. Staff recommends that the Commission adopt an overall rate of return of 9.5 percent. Staff's recommendation is based on a 75.2 percent debt and a 24.8 percent equity capital structure.

**Q. Does this conclude your direct testimony?**

A. Yes, it does.

## Qwest Corporation
## Capital Structure
## And Weighted Cost of Capital

| Line No. | [A] | [B] Weight (%) | [C] Cost | [D] Weighted Cost |
|---|---|---|---|---|
| 1 | **Long-term Debt** | 75.2% | 7.81% | 5.87% |
| 2 | **Common Equity** | 24.8% | 14.6% | 3.63% |
| 3 | | | | |
| 4 | **Weighted Average Cost of Capital/ROR** | | | 9.5% |
| 5 | | | | |
| 6 | | | | |
| 7 | | | | |
| 8 | | | | |
| 9 | | | | |
| 10 | Supporting Schedules: Schedule AXR-5 | | | |

Staff Witness Mr. Reiker Direct

### Capital Structure of Sample Telecos

| Company | Debt Percentage[1] | Equity Percentage[1] |
|---|---|---|
| BellSouth | 36.8% | 63.2% |
| CenturyTel, Inc. | 47.2% | 52.8% |
| Citizens Communications | 74.8% | 25.2% |
| ALLTel | 44.3% | 55.7% |
| SBC Communications | 29.6% | 70.4% |
| Verizon | 54.1% | 45.9% |
| **Average** | 47.8% | 52.2% |
| Qwest Intl. | 106.9% | -6.9% |
| Qwest Corporation | 75.2% | 24.8% |

Sources: Applicant's Filing & Hoover's Online
[1] For the Year 2003

Qwest Corporation
Docket No. T-01051B-03-0454

Schedule AXR-3

### Qwest Corporation Long-term Debt Rating

| Credit Agency | June 30, 2004 | December 31, 2003 |
|---|---|---|
| Standard & Poor's | BB- | B- |
| Moody's | Ba3 | Ba3 |
| Fitch Ratings | BB | B |

Source: Qwest Corporation 10-Q filed for ending period June 30, 2004

### Summary of Rating Agency Categories

| | Credit Agency | | |
|---|---|---|---|
| Standard & Poor's | Moody's | Fitch Ratings | Description |
| AAA | Aaa | AAA | Extremely strong capacity to meet financial commitments |
| AAA- | Aaa | AAA- | |
| AA+ | Aa1 | AA+ | |
| AA | Aa2 | AA | Very strong capacity to meet financial commitments |
| AA- | Aa3 | AA- | |
| A+ | A1 | A+ | |
| A | A2 | A | Strong capacity to meet financial commitments |
| A- | A3 | A- | |
| BBB+ | Baa1 | BBB+ | |
| BBB | Baa2 | BBB | Adequate capacity to meet financial commitments |
| BBB- | Baa3 | BBB- | |
| BB+ | Ba1 | BB+ | |
| BB | Ba2 | BB | |
| BB- | Ba3 | BB- | |
| B+ | B1 | B+ | |
| B | B2 | B | |
| B- | B3 | B- | Speculative characteristics |
| CCC+ | - | CCC+ | |
| CCC | - | CCC | |
| CCC- | - | CCC- | |
| CC+ | - | CC+ | |
| CC | - | CC | |
| CC- | - | CC- | |
| D | - | D | Default has occurred |

**Bond Ratings for the Sample Telecos**

| Company | S&P | Moody's |
|---|---|---|
| BellSouth | A+ | Aa3 |
| CenturyTel, Inc. | BBB+ | Baa2 |
| Citizens Communications | BB+ | Ba3 |
| ALLTel | A | A2 |
| SBC Communications | A+ | Aa3 |
| Verizon | A+ | A1 |

Source: C.A. Turner Utility Reports, August 2004

## Qwest Corporation Cost of Debt Allocated to Arizona

| | | ------Interest------ | |
|---|---|---|---|
| Description | Total Capital | Total | Cost of Debt |
| Short Term Borrowings | $0 | $0 | |
| Current Maturities - LT Debt | $142,865,764 | $10,026,105 | |
| Premium | $0 | $0 | |
| Discount | $83,927 | $94,568 | |
| Debt Iss. | $156,862 | $176,583 | |
| Net Funded Debt | $142,624,975 | $10,297,256 | 7.22% |
| Current Maturities - Capital Leases | $1,576,704 | $135,804 | 8.61% |
| Total ST Debt | $144,201,678 | $10,433,060 | 7.24% |
| Funded Debt | $1,147,851,781 | $84,497,330 | |
| Premium on LT Debt | $109 | $77 | |
| Discount on LT Debt | $25,649,989 | $464,554 | |
| Debt Issuance Expenses | $27,201,468 | $1,452,999 | |
| Net Funded Debt | $1,095,000,433 | $86,414,805 | 7.89% |
| Obligations Under Capital Leases | $1,190,246 | $111,715 | 9.39% |
| Other Long Term Debt | $2,609,385 | $170,132 | 6.52% |
| Total LT Debt | $1,098,800,065 | $86,696,652 | 7.89% |
| Total ST + LT Debt | $1,243,001,744 | $97,129,713 | 7.81% |

Qwest Corporation Exhibit 1

Docket No T-01051B-03-0454

## NOTE 8: SUBSEQUENT EVENTS[2]

### Note 8: Subsequent Events

During the second quarter of 2004, we declared cash dividends of $253 million and paid cash dividends of $910 million. We have historically declared and paid regular dividends to our parent, QSC, based on the earnings of our wireline operations. In July 2004, we modified our dividend practice to balance our financial needs, cash position and credit profile with those of our parent. As a result, going forward, we may declare and pay dividends in excess of our earnings. In addition, during July 2004, we declared dividends of $400 million.

[2] Taken from QC's 10-Q filed on August 06, 2004, page 24.

**BEFORE THE ARIZONA CORPORATION COMMISSION**

| | | |
|---|---|---|
| IN THE MATTER OF QWEST CORPORATION'S FILING AMENDED RENEWED PRICE REGULATION PLAN | ) ) ) | DOCKET NO. T-01051B-03-0454 |
| IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS | ) ) | DOCKET NO. T-00000D-00-0672 |

# DIRECT TESTIMONY OF STEVEN C. CARVER, MICHAEL L. BROSCH AND STAFF JOINT ACCOUNTING SCHEDULES

**ON BEHALF OF THE STAFF OF THE ARIZONA CORPORATION COMMISSION**

**PUBLIC VERSION**

("Highlighted" Text Denotes Confidential Material)

**NOVEMBER 18, 2004**

**BEFORE THE ARIZONA CORPORATION COMMISSION**

| | | |
|---|---|---|
| IN THE MATTER OF QWEST CORPORATION'S FILING AMENDED RENEWED PRICE REGULATION PLAN | ) ) ) | DOCKET NO. T-01051B-03-0454 |
| IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS | ) ) | DOCKET NO. T-00000D-00-0672 |

**DIRECT TESTIMONY**

**OF**

**STEVEN C. CARVER**

**ON BEHALF OF THE STAFF OF THE ARIZONA CORPORATION COMMISSION**

**PUBLIC VERSION**

("Highlighted" Text Denotes Confidential Material)

**NOVEMBER 18, 2004**

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## DIRECT TESTIMONY OF STEVEN C. CARVER



### Attachments

**BEFORE THE**
**ARIZONA CORPORATION COMMISSION**
**DIRECT TESTIMONY OF**
**STEVEN C. CARVER**

**QWEST CORPORATION**
**DOCKET NOS. T-01051B-03-0454 & T-00000D-00-0672**

Q. Please state your name and business address.

A. My name is Steven C. Carver. My business address is 740 NW Blue Parkway, Suite 204, Lee's Summit, Missouri 64086.

Q. What is your present occupation?

A. I am a principal in the firm Utilitech, Inc., which specializes in providing consulting services for clients who actively participate in the process surrounding the regulation of public utility companies. Our work includes the review of utility rate applications, as well as the performance of special investigations and analyses related to utility operations, cost allocation and ratemaking issues.

Q. On whose behalf are you appearing in this proceeding?

A. Utilitech was retained by the Staff of the Arizona Corporation Commission (hereinafter "Staff" or "ACC Staff") to review and respond to the revenue requirement filed by Qwest Corporation ("Qwest" or "Company"), as ordered by the Arizona Corporation Commission ("ACC" or "Commission") pursuant to R14-2-103. The scope of work undertaken by Utilitech included submission of testimony with this Commission regarding the results of our review, primarily regarding Qwest's test year revenue requirement under the traditional approach to utility regulation.

Q. Have you previously testified before this Commission in proceedings that involved Qwest or its predecessor companies?

A. Yes. Mr. Michael Brosch, also of Utilitech, and I have prepared and presented revenue requirement recommendations in a number of proceedings involving Qwest or U S West

Communications. I have filed testimony in three of the Company's previous Arizona rate cases (Docket Nos. E-1051-88-146, E-1051-93-183 and T-1051B-99-105) dating back to 1989. I have also filed testimony in two proceedings before the Washington Utilities and Transportation Commission (Docket Nos. UT-930074 and UT-950200) as well one proceeding before both the Utah Public Service Commission (Docket No. 97-049-08) and the New Mexico Public Regulation Commission (Utility Case No. 3008).

Q. Please summarize the purpose and content of your testimony.

A. Generally, my responsibilities in this docket encompass the review and evaluation of various elements of rate base and operating income included within the overall revenue requirement. As a result, I address various adjustments to rate base and operating income, identified on the earlier table of contents, as well as introduce Staff's proposed capital structure (Schedule D) sponsored by Staff witnesses Joel Reiker and Alejandro Ramirez. The additional ratemaking adjustments, which I do not sponsor, are separately addressed in the direct testimony of Staff witnesses Michael Brosch and William Dunkel. The revenue requirement effect of the various Staff adjustments and recommendations are reflected within the Staff Joint Accounting Schedules.

## EDUCATION AND EXPERIENCE

Q. What is your educational background?

A. I graduated from State Fair Community College, where I received an Associate of Arts Degree with an emphasis in Accounting. I also graduated from Central Missouri State University with a Bachelor of Science Degree in Business Administration, majoring in Accounting.

Q. Please summarize your professional experience in the field of utility regulation.

A. From 1977 to 1987, I was employed by the Missouri Public Service Commission ("MoPSC") in various professional auditing positions associated with the regulation of public utilities. In April 1983, I was promoted by the Missouri Commissioners to the position of Chief Accountant and assumed overall management and policy responsibilities for the Accounting Department. I provided guidance and assistance in the technical development of Staff issues in major rate cases and coordinated the general audit and administrative activities of the Department.

I commenced employment with the firm in June 1987. During my employment with Utilitech, I have been associated with various regulatory projects on behalf of clients in the States of Arizona, California, Florida, Hawaii, Kansas, Illinois, Iowa, Indiana, Mississippi, Missouri, Nevada, New Mexico, New York, Oklahoma, Pennsylvania, Texas, Utah, Washington, West Virginia and Wyoming. I have conducted revenue requirement and special studies involving various regulated industries (i.e., electric, gas, telephone and water). Since joining the firm, I have also appeared as an expert witness before the MoPSC on behalf of various clients, including the Commission Staff. Additional information regarding my professional experience and qualifications are summarized in Attachments SCC-1 and SCC-2.

## EXECUTIVE SUMMARY

Q. What is the overall revenue requirement proposed by Staff for Company's Arizona intrastate regulated operations?

A. Qwest submitted its prefiled testimony and required schedules[1] on May 24, 2004, subsequently revised on June 21, 2004. The Company's revised filing presents an overall intrastate revenue deficiency of $318.5 million (original cost) and $458.8 million (fair value).[2] The revised filing (June 21, 2004) was based on a historical test year ended December 31, 2003, with certain known and measurable ratemaking adjustments recognizing various prospective changes. In comparison, Staff has assembled a revenue requirement recommendation, based on an internally consistent test year approach, supporting an overall revenue increase of approximately $3.53 million. A series of accounting schedules supporting the Staff's recommended adjustments are set forth in the Staff Joint Accounting Schedules.

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1 Qwest Corporation filing pursuant to A.A.C. R14-2-103(B)(7) or "R14-2-103" filing.
2 See Qwest Schedule A-1, filed June 21, 2004.

Q. Did the Company propose to recoup the entire $318.5 million deficiency through changes in existing tariff rates and price lists?

A. No. The Company did request an increase in AUSF support of approximately $64 million as well as several million dollars in increased miscellaneous revenues. However, the Company has also sought significant additional pricing flexibility, which may provide an opportunity for Qwest to recoup a larger portion of the remaining deficiency.

Q. Please summarize the ratemaking adjustments proposed by Staff that contribute to this difference between the revenue requirement recommendations of Company and Staff.

A. Schedule E of the Staff Joint Accounting Schedules represents a reconciliation of the various differences between the overall revenue requirement recommendations of Company and Staff.

Q. How are the Staff Accounting Schedules organized?

A. Within the joint accounting schedules, the components of the Staff's proposed revenue requirement appear on Schedule A, Change in Gross Revenue Requirement. The Staff's proposed rate base is brought forward from Schedule B, Summary of Jurisdictional Rate Base. Similarly, Staff's adjusted net operating income recommendation is brought forward from Schedule C, Summary of Operating Income. The components comprising Staff's cost of capital recommendation (i.e., rate of return) are detailed on Schedule D, Capital Structure & Costs.

Jurisdictional separation factors, applied to isolate the Arizona intrastate portion of each Staff adjustment, are summarized on Schedule F – based on revised composite intrastate separations factors resulting from the exclusion of FCC nonregulated services as discussed in a subsequent testimony section. The development of the gross revenue conversion factor used to convert the net operating income deficiency on Schedule A into the appropriate revenue requirement amount is set forth on Schedule A-1.

Staff's recommended adjustments to rate base and operating income are supported by individual schedules, also contained within the joint accounting schedules. The witness sponsoring each adjustment and schedule comprising the Staff's overall revenue requirement recommendation is identified in the upper left-hand corner thereof and listed on the schedule index located at the front of Staff Joint Accounting Schedules.

Q. How will you identify and refer to the individual accounting adjustments?

A. Both rate base and operating income adjustments have been numbered sequentially, but separately, beginning with the number "one". In order to distinguish the first rate base adjustment from the first operating income adjustment, the adjustment number is preceded by a reference to the schedule on which the adjustment was posted. For example, the posting schedule for the rate base adjustments is Schedule B. So, the first rate base adjustment would then be referenced as Schedule (or Adjustment) B-1. Similarly, the first operating income adjustment would be identified as Schedule (or Adjustment) C-1, since Schedule C is the posting schedule for the income statement adjustments. For purposes of testimony presentation in this proceeding, Mr. Brosch and I will use the words "schedule" and "adjustment" interchangeably when referring to the individual adjustments proposed by Staff.

Q. Do the joint accounting schedules provide calculation detail supporting each Staff adjustment?

A. Yes. The joint accounting schedules contain individual adjustment "schedules" that show the quantification of each rate base and operating income adjustment, with footnote references to supporting documentation. Since virtually all information relied upon by Staff in developing these adjustments was supplied by Qwest in response to written discovery, the adjustment schedules will refer to the relevant data sources, already in the Company's possession, that represent the primary support for the Staff adjustments affecting overall revenue requirement.

Q. Please describe Staff's approach to quantifying revenue requirement in this proceeding.

A. The Staff's joint accounting schedules use Qwest's "prefiled" amounts (as revised on June 21, 2004) for rate base, revenues and expenses as a starting point. The Company's proposed amounts were then adjusted to reflect the impact of the various revisions provided by Qwest[3] as well as modifications recommended by Staff witnesses.

By starting with the Company's proposed amounts, each ratemaking adjustment recommended by Staff represents a reconciling difference, positive or negative, between the overall revenue requirement recommendations of Staff and Qwest. In fact, Staff's Schedule E represents a reconciliation of the individual revenue requirement differences between the Company and Staff, by individual item.

Q. Please describe how the remainder of your testimony is organized.

A. The remainder of my testimony is arranged by topical section, following the table index presented previously. This index identifies the specific areas I address in testimony and references the testimony pages as well as any related adjustment support located in the joint accounting schedules.

## TEST YEAR

Q. Please briefly describe the test year approach used in this proceeding.

A. As discussed previously, Qwest's revenue requirement is based on a historical test year ended December 31, 2003, with various ratemaking adjustments discussed in the direct testimony of Company witness Philip E. Grate[4]. Although Mr. Grate identifies only one post-test year pro forma adjustment proposed by Qwest, the Company sponsors ten (10) rate base and twenty-three (23) operating income adjustments that fall into three basic categories: accounting pro forma adjustments; normalizing pro forma adjustments; and ratemaking pro forma adjustments.[5] However, the Company is not seeking to recover the full amount of its asserted revenue deficiency through increases in its various tariff rates, as indicated by Mr. Grate:[6]

> Schedule A-1 of Qwest's Rule 103 filing computes Qwest's Arizona revenue requirement. Given the intensity of competition Qwest now faces

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[3] Staff Adjustments B-1 and C-1, jointly sponsored with Mr. Brosch, recognize corrections Qwest has identified to its June 21, 2004, filing in response to Staff Data Requests UTI 1-1 and 7-2.

[4] Grate direct testimony, pp. 37-41.

[5] Grate direct testimony, pp. 46-52.

[6] Grate direct testimony, p. 10.

> in Arizona and the pace of Qwest's Arizona access line loss, Qwest does not believe the revenue requirement computed in the schedules of its Rule 103 filing is fully recoverable from its Arizona customers. Therefore, Qwest is not proposing rates to fully recover its revenue requirement. Instead, Qwest is proposing modifications to its price regulation plan that will allow the Company to compete on a more equal footing with its competition in Arizona.

Utilitech was retained by the ACC Staff to review Qwest's traditional revenue requirement filing and to present the results of our review, not to address Qwest's proposed modifications to the Company's price regulation plan. Staff witness Mathew Rowell discusses the price regulation plan in his direct testimony.

Q. With regard to the traditional revenue requirement elements of Qwest's filing, has the Company proposed a year-end or average approach in quantifying overall revenue requirement?

A. Generally, Qwest has proposed end-of-period investment, revenues and wage rates. However, certain elements of the ratemaking formula are based on average test year levels in areas such as: employee levels and general non-labor operating expenses.

Q. How does the Company's general test year approach compare to that employed by the Staff?

A. In quantifying its revenue requirement recommendation, the Staff concurs with the use of 2003 historical test year, with fixed, known and measurable changes through December 2003.

Q. Why is the selection and balanced adjustment of a test year important in the determination of just and reasonable utility rates?

A. The ratemaking equation commonly employed by this Commission, and other regulatory agencies, compares a required return on rate base to the investment return generated by adjusted test year operating results. If the return indicated by the adjusted operating results (i.e., adjusted test year operating income and rate base) is deficient, an increase in revenues is required to provide the utility an opportunity to earn a "reasonable" return on its investment. Conversely, an excessive return would support a reduction in utility revenues and rates.

For the ratemaking equation to function properly, the components comprising the equation (i.e., rate base, revenues, expenses and rate of return) must be reasonably representative of ongoing levels, internally consistent and comparable – within the context of test period parameters. To the extent that these components are not properly synchronized, a utility may not have the opportunity to earn its authorized return or, alternatively, may have the opportunity to earn in excess of the return authorized. By synchronizing or maintaining the comparability of revenues, expenses and investment, the integrity of the test year can be maintained with the reasonable expectation that the resulting rates will not significantly misstate the ongoing cost of providing utility service.

Consequently, it is critical that the ratemaking process properly synchronize only those known and measurable changes which occur during the test year or within a reasonably defined period subsequent thereto, rather than establish utility rates on inappropriate factors or inconsistent post-test year events. In this manner, regulators can best be assured that rates are reasonably based on ongoing cost levels.

Q. Could you explain the concept of "known and measurable" changes, as commonly used in the ratemaking process?

A. Yes. In general terms, regulatory agencies often recognize "known and measurable changes" to operating revenues, expenses and operating income that occur within a predefined period following the test year. In my opinion, the following definition or explanation of the "known and measurable" concept is commonly applied in utility ratemaking, consistent with past Arizona practice:

> **Known and measurable changes** -- transactions or events that are:
> (a) Fixed in time. A qualifying transaction or event must occur or be reasonably certain to occur within or immediately following the test year – synchronized with other material elements of the ratemaking equation.
> (b) Known or reasonably certain to occur. The transaction or event must be "known" to exist or be highly probable to occur, in contrast with possible, uncertain or speculative changes.

(c) Measurable in amount. The financial effect of the transaction or event can be "measured" or accurately quantified.

In this context, a transaction or event should only be considered "known and measurable" if it has been agreed to by contract or commitment, can be verified to have occurred within the specified time period, and can be quantified employing actual data or reasonable estimates. However, the events giving rise to the qualifying transaction must occur within a specified and consistent period.

It is not uncommon for regulatory commissions to recognize or annualize transactions occurring within, or subsequent to, the historical test period for verifiable, yet balanced, changes which will impact a utility's future earnings. However, it is also true that parties often differ on whether offsetting factors have been appropriately considered (i.e., properly matched) and how far outside the test year it may be appropriate to reach for changes. In the absence of a reasonable balance or matching, a distorted view of the cost of service will lead to improper rate adjustments. A consistent matching of material price and quantity changes is necessary to achieve this balance, particularly when volume changes, during or subsequent to the test year, offset price level changes.

Q. How should the Company proposed adjustments that reach beyond test year-end for price or quantity changes be handled?

A. The test year cut-off should be consistently applied to all material changes in rate base, revenues, expenses and other operating income items. For example, an announced 1¢ postal rate increase effective September 1, 2003, would fall within the test year. Presuming the availability of the data required to accurately quantify the annual pro forma impact of such an increase on test year postage expense, an adjustment to annualize this "known" price change would meet the known and measurable criteria, all else remaining equal.

Instead of a postal rate increase, assume that the utility announced a 1% wage increase effective June 1, 2004. While this increase might be known and might be measurable, the specified change falls well outside the test year. Absent a wholesale update of the test year for all material known and measurable changes through June 2004, the June 2004 wage increase would not be eligible for annualization purposes.

Q. Based on your regulatory experience, is it reasonable to expect that changes occurring subsequent to a rate case test year will automatically put upward pressure on the cost of providing utility service?

A. No. It may be anticipated that the passage of time may result in increasing expenses and plant investments, during periods of even modest inflation. As a result, the use of an end-of-period, or post-test year, rate base and the recognition of various revenue/ expense annualization and/ or normalization adjustments might be expected to consistently yield higher revenue requirements. However, the rate of depreciation reserve growth may materially mitigate growth in plant investment, while revenue trends, productivity gains from technology and reductions in certain operating expenses may offset the presumption of a generally increasing cost of service. These favorable and unfavorable revenue requirement influences can offset one another for many years, explaining how many utilities have avoided base rate increases for extended periods of time.

<u>All</u> components of the ratemaking equation change over time. It is only by consistently analyzing the major cost of service components that a determination can be made as to whether the overall revenue requirement has changed materially. The key issue is whether revenues are growing faster or slower than the overall costs, including investment return, necessary to support those revenues.

## QWEST UPDATE – CORRECTIONS & REVISIONS

Q. Why are Staff Adjustments B-1 and C-1 necessary?

A. During the course of Staff's review of the Company's June 21, 2004, revised R14-2-103 Filing, Qwest's responses to various Staff and RUCO discovery requests have identified various corrections or revisions the Company believes are necessary to that filing. Since Staff's revenue requirement recommendation is based on adjusting the Company's proposed values for rate base and operating income, it was necessary for Staff to post the Company's revisions to the June 2004 filed amounts, in lieu of a formal revision to

Qwest's R14-2-103 Filing. Staff Adjustments B-1 and C-1 represent composite adjustments that combine the various modifications identified by the Company.

Q. Are you sponsoring these adjustments?

A. Mr. Brosch and I jointly sponsor these corrections the Company has indicated are necessary to its June 2004 R14-2-103 filing. By posting these adjustments, we are not necessarily adopting or agreeing with those Company modifications. Rather, we are merely reflecting the changes Qwest believes are necessary to its June 2004 filing. In fact, Mr. Brosch and I specifically sponsor adjustments that further correct, modify or reverse all or portions of individual Company revisions.

Q. Could you briefly describe how Staff Adjustments B-1 and C-1 are organized?

A. Yes. The Company has identified various adjustments, which affect rate base and/ or operating income. Staff Adjustment B-1 merely compiles those portions of each of these Company revisions that impact rate base into one consolidated rate base adjustment. Staff Adjustment C-1 reflects a similar approach to operating income.

Q. What was the data source of the various Company adjustments included in Staff Adjustments B-1 and C-1?

A. In response to various Staff discovery, but more specifically Staff Data Requests UTI 1-1 and 7-2, Qwest has been providing the quantification of the revisions to its filing. This data from the Company serves as the basis for these Staff adjustments. Since late summer, we have also had several discussions with Company and Staff representatives about this revision process.

## TELEPHONE PLANT UNDER CONSTRUCTION (TPUC)

Q. Please describe Staff Adjustments B-5 and C-8.

A. In assembling its R14-2-103 filing, Qwest proposed a pro forma accounting adjustment (PFA-04) to change from the "capitalization" method to the "revenue requirement offset" method of accounting for telephone plant under construction ("TPUC"). Under the revenue requirement method, Qwest originally proposed to increase intrastate rate base by $20,406,000 and increase net operating income by $101,000. Subsequent Company revisions now increase rate base by $20,148,000[7] and decrease net operating income by $157,000. Staff Adjustments B-5 and C-8 reverse the revised Qwest adjustments to rate base and net operating income.

Q. What is TPUC?

A. TPUC represents the original cost of construction projects not yet completed and in service – that is, an investment in projects that are not yet used and useful in providing utility service. The FCC Uniform System of Accounts ("USOA" or "Part 32") requires that all TPUC expenditures be charged to Account 2003, unless the construction project is estimated for completion within two months or the gross additions are expected to be less than $100,000. The construction cost of those projects of short duration or small amount may be charged directly to the appropriate plant account. Under the current FCC USOA, telecommunications companies are no longer required to maintain different accounts for short-term and long-term construction projects, although Qwest has continued to maintain this distinction because of intrastate regulatory accounting requirements.[8]

Q. Of the $20.1 million increase to rate base, what is the relative distribution between short-term and long-term construction projects?

A. According to the Company workpapers supporting Adjustment PFA-04, the TPUC balance included in rate base is predominantly related to short-term TPUC.[9] When the TPUC issue was last litigated in Docket No. E-1051-93-183, the Company had sought to include about $29.3 million of short-term TPUC ("STPUC") in rate base.[10]

Q. Why has Qwest proposed to include TPUC in rate base?

A. Although Mr. Grate has sponsored eleven pages of testimony discussing three methods used to account for TPUC, none of his testimony actually addresses why the Company

[7] The TPUC component of revised Qwest Adjustment PFA-04 is $21,023,000 compared to $21,448,000 in the original Company adjustment.

[8] See response to UTI 2-1, Attachment A, Technical Accounting RA-1-74, Account 2004.

[9] Original balance was comprised of short-term TPUC of $19,176,866 and long-term TPUC of $2,270,992.

[10] See Decision No. 58927, pp. 5-6 (ACC Docket No. E-1051-93-183, January 3, 1995).

has sought to include TPUC in rate base for intrastate revenue requirement purposes. However, he does offer a simplified analysis of three methods of accounting for TPUC: capitalization method, rate base method and revenue requirement method. Through this analysis, Mr. Grate attempts to show that the capitalization method, currently authorized by the ACC, "does not provide an opportunity for full recovery of the cost of construction." [Grate direct, p. 69] It appears that Mr. Grate has mistakenly focused his analysis on whether the capitalization method yields the same return to the Company as the other rate base alternatives. This analysis will be discussed in more detail later in my testimony.

Q. Why should TPUC be excluded from rate base?

A. A telecommunications provider, or other regulated enterprise, may expend funds for construction in order to modernize plant, replaced damaged or worn out facilities, or meet the demands of growth or entry into new markets. The completion of a construction project may allow the Company to realize improved efficiencies, cost savings and/ or additional revenue.

As discussed in the earlier test year section of my testimony, it is critical for the elements of a test year to be representative of ongoing levels and to be internally consistent and comparable. The TPUC projects the Company has proposed to include in rate base, were not completed or in-service as of the end of the test year (December 31, 2003). Because these projects were not used and useful during the test year, any related benefits (e.g., cost savings, new revenues, etc.) reasonably expected to arise from these uncompleted projects would, by definition, only be realized subsequent to the test year. Since no adjustments have been proposed by Company or Staff to reach out beyond the test year to capture TPUC related post-test year savings or revenues in determining revenue requirement, it would be inappropriate to include in rate base any expenditures for uncompleted plant because of the inherent mismatch such inclusion would introduce into the ratemaking process.

Q. How much of the Company's construction expenditures relate to growth or are viewed as being revenue production or likely to result in cost savings?

A. I do not know. Staff Data Request UTI 16-15 requested this information, but the response thereto indicated that Qwest does not maintain or have a breakdown of the TPUC investment between new growth or revenue producing projects, efficiency or cost savings projects, replacement projects, and non-revenue producing or non-cost savings projects. Apparently, the Company has no need for this information. Further, this response also states: "The Company's revenue requirement calculation does not include any additional revenues, cost savings or efficiencies that may be expected to be realized by plant under construction." Curiously, the response observes that the recognition of such amounts, if known, "would violate the proper construction of the test year" – even though such revenues, savings or efficiencies would result from the very uncompleted projects Qwest proposed to include in rate base. Finally, the response to Staff Data Request UTI 16-15 indicates that the FCC did not require these offsets when the revenue requirement offset method was adopted. So, it is not possible to assess what proportion of TPUC may reasonably be expected to result in new sources of revenues or other cost savings.

Q. Has it been uncommon for State regulatory commissions to exclude TPUC from rate base?

A. No. I have not seen a national survey of this type of data since the mid-1990's. However, in ACC Docket No. E-1051-93-183, Qwest reported that ten of the thirteen other States in which the Company operates excluded short-term TPUC from rate base.[11] The disallowance of TPUC from rate base is not unique to Qwest. Over the years, I have been involved in a number of regulatory proceedings in various jurisdictions. In my experience, the discussion of including TPUC (or CWIP for energy companies) in rate base has addressed a variety of issues, such as test year matching concerns and requirements to demonstrate that rate base inclusion is needed to maintain the regulated entity's financial integrity.

[11] Company response to Staff Data Request No. UTI-108 in Docket No. E-1051-93-183.

Q. Would the exclusion of TPUC from rate base jeopardize Qwest financial integrity in Arizona?

A. No, I do not believe so. Based on historical information set forth on Schedule E-3, Comparative Statement of Cash Flows, from Qwest's June 2004 revised R14-2-103 filing, the Company's Arizona construction expenditures have been more than met by internally generated funds over the last three years.

Q. Will your proposal to exclude TPUC from rate base deny the Company the opportunity to earn a return on those construction expenditures?

A. No. In Decision No. 58927, the Commission adopted Staff's recommendations and excluded short-term TPUC from rate base. Furthermore, all TPUC has and will continue to accrue an allowance for funds used during construction ("AFUDC") at the approved capital cost authorized herein until the project is completed and ready for service.

## Arizona: Historical Treatment of TPUC

Q. When did the Company last present the rate base inclusion of TPUC to the Commission?

A. In the Company's last rate case, the Company did not seek rate base inclusion of TPUC. To the best of my knowledge, the Company's 1993 rate case (Docket No. E-1051-93-183) was the last rate proceeding in which Qwest sought rate base treatment. In Docket No. T-1051B-99-105, the Company's rate filing did not propose inclusion of TPUC in rate base.

Q. Were you involved in the Company's 1993 Arizona rate case?

A. Yes. I was the Staff witness who sponsored the testimony excluding TPUC from rate base, which was adopted by the Commission. The basis for the Commission's decision on this issue is clearly set forth in the following excerpt from Decision No. 58927:

> The Company included $29,282,000 of short-term plant under construction ("STPUC") in its original application. The Company included the STPUC since it was expected to be in service before new rates were approved in this case.
>
> Staff recommended removal of STPUC because of the inherent mismatch that would result from its inclusion. According to Staff, there will be benefits from the completion of the plant which will not be

> recognized until a subsequent rate proceeding. In place of STPUC, Staff recommended the Company be authorized to continue the capitalization of an allowance for funds used during construction ("AFUDC") until the project is completed and ready for service. At that point, the Company would prepare an off-book computation of monthly depreciation expense on the capitalized AFUDC accumulated with STPUC, and maintain an accumulated depreciation reserve. According to Staff, this procedure should provide the amount of AFUDC to be included in plant-in-service and the depreciation reserve in future rate cases.
>
> In response, the Company indicated it would still prefer inclusion of STPUC in rate base. However, the Company agreed either method would be acceptable.
>
> Under the circumstances presented herein, we will adopt Staff's position and remove STPUC from rate base. Furthermore, all STPUC will continue to accrue AFUDC at the approved capital cost authorized herein until the project is completed and ready for service.
>
> [Decision No. 58927, pp. 5-6]

To my knowledge, this is the only litigated rate case in which the Commission considered and affirmatively addressed how TPUC should be handled for ratemaking purposes.

Q. At pages 66 and 67 of his direct testimony, Mr. Grate discusses the history of the ACC on the ratemaking treatment of TPUC, indicating that the Commission has switched from the capitalization method prior to 1982 to the rate base method in 1983 and reverting to the capitalization method in 1993. Do you agree with that characterization?

A. No. The Commission's findings in Decision No. 53040 (Docket No. 9981-E-1051-406) were based on a negotiated settlement. The following language appears in that order concerning short-term TPUC:

> Mountain Bell also seeks to have the Corporation Commission adopt and apply for intrastate ratemaking purposes changes to the Uniform System of Accounts relating to the treatment of the telephone plant under construction and interest during construction made by the Federal Communications Commission effective January 1, 1979. Under the stipulated settlement, the Corporation Commission will adopt and apply the directives of the Federal Communications Commission for intrastate ratemaking purposes. This will result in interest during construction no longer being accrued on short term plant under construction. Instead, short term plant under construction shall be included in the rate base.
>
> [Decision No. 53040, p.5]

However, it is important to recognize that Decision 53040 was indeed based on a stipulated settlement, the nature of which is further discussed in the following excerpt from that same order:

> This stipulation is entered into with the express understanding and agreement that all negotiations and offers of settlement and discussions relating thereto and this stipulation, itself, are the result of an attempt to resolve and compromise disputed and controverted positions. Accordingly, this stipulation and all negotiations and settlement conferences leading up to this agreement are made without prejudice to any party and are not admissible in evidence or deemed to be an admission against interest by any party hereto of any matter considered or discussed or contained herein, directly or indirectly. Furthermore, <u>this stipulation, any order of this Commission entered pursuant to this stipulation</u>, and the settlement offers leading thereto <u>shall not be used in any manner</u> by the parties hereto or any other party whatsoever, <u>in any litigation, proceeding or docket pending, existing or to be tried in the future, it being expressly and clearly recognized that this stipulation is considered a nonprejudicial compromise of the parties' positions in this proceeding only</u>.
>
> ...
>
> <u>This stipulation shall not be binding on any party in any subsequent proceeding, docket or litigation</u>.
>
> [Decision No. 53040, p.12; Emphasis Added]

In my opinion, the above language means exactly what it says. Decision No. 53040 was based on a negotiated, nonbinding settlement. Consequently, I do not concur with any implication that this order represents a careful and deliberate consideration of detailed evidence presented in that proceeding with a conclusion by the Commission that TPUC was properly includable in rate base.

Q. In this same portion of his direct testimony, Mr. Grate also states that the Commission used the rate base method on short-term TPUC in its 1983 and 1986 rate decisions. Did the Commission issue any rate orders subsequent to Decision No. 53040 which included short-term TPUC in rate base?

A. Yes. In February 1983, the Company filed an application (Docket No. E-1051-83-035) seeking an overall rate increase. This docket was a contested case proceeding, resolved by Decision No. 53849. Although a review of this decision does indicate that TPUC was included in rate base[12] net of a minor disallowance, the policy issue of whether short-term TPUC should be included or excluded from rate base was not presented to nor addressed by the Commission – rather the parties agreed on rate base inclusion. While it was the regulatory intent of the parties to include TPUC in rate base, this order does not present a conclusive determination by the Commission, as the rate base method was not presented as a litigated issue.

A similar factual situation arose in Docket No. E-1051-84-100, pursuant to a rate increase application filed by the Company in October 1984. In Decision 54843, the Commission again included short-term TPUC in rate base, after accepting certain adjustments proposed by Staff decreasing the amount requested by the Company.[13] Again, TPUC was included in rate base by agreement of the parties, but the Commission was not presented with the policy issue of whether such inclusion was appropriate.

Docket No. E-1051-88-146 arose from a Commission initiated investigation of the Company's rates and charges, which resulted in the issuance of a complaint against a predecessor company, US West, directing the Company to show cause why its rates should not be reduced. In interim Decision No. 56363 (issued February 22, 1989), the Commission concluded that Staff had met its burden that a $33.4 million interim rate decrease was warranted. Although Decision No. 56363 (page 7) referenced the issue as uncontroverted, the Commission adopted a Staff adjustment removing short-term TPUC from rate base in quantifying the amount of the interim rate decrease. Subsequent to that interim order, the Commission issued Decision No. 56471 making the interim decrease permanent, with an additional $3.9 million reduction to touch tone rates, and rescinded Decision No. 56363 pursuant to an agreement between the Company and Staff.

In Docket No. E-1051-91-004, the Commission issued Decision No. 57462 adopting a global settlement between the Company and Staff, authorizing a $78.8 million rate

[12] Decision No.53849 (December 22, 1983), pp. 16-17 & 21.
[13] Decision No.54843 (January 10, 1986), pp. 26 & 28.

increase. This order resolved all rate case issues without addressing the disposition of any particular issue, including short-term TPUC.

Q. What is your view of this history of the Commission's rate base treatment of TPUC?

A. In my opinion, the Commission had not clearly articulated a policy position regarding the rate base treatment of TPUC until Docket No. T-1051B-99-105. While the regulatory intent of the parties may be clear, the Commission did not reach an affirmative disposition of this issue as the matter was either included in a settlement or not presented as an issue in the other proceedings identified by Mr. Grate. I believe that any implications otherwise would mischaracterize the facts and circumstances surrounding those individual proceedings.

Q. At page 72 of his direct testimony on the TPUC issue, Company witness Grate indicates that Qwest should not be required to substantiate the existence of ratepayer benefits before the Commission can approve adoption of the "revenue requirement offset" method, stating:

> Whether an accounting method favors ratepayers over investors or investors over ratepayers is not an appropriate criterion for determining the desirability of one accounting method over another. No one could reasonably assert that ratepayers should be subjected to an accounting method solely because it produces a higher revenue requirement than another method. It is no less true that investors should not be subjected to accounting method solely because it yields a lower revenue requirement than another method. The choice of accounting methods should turn on which method yields the most accurate reflection of actual costs and actual results of operations.

In deciding to adopt the capitalization method for short-term TPUC in Decision No. 58927,[14] did the Commission adopt Staff's recommendation on the basis that the capitalization method favors ratepayers over shareholders?

A. No. As indicated by the earlier excerpt from Decision No. 58927, the Commission's adoption of the capitalization method was not based on whether the method favored ratepayers or investors – instead focusing on the inherent mismatch that would result.

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[14] ACC Docket No. E-1051-93-183, January 3, 1995.

**FCC Accounting Requirements**

Q. At page 63 through 68 of his direct testimony, Mr. Grate discusses the FCC's accounting for TPUC including a discussion of its Report and Order in CC Docket No. 93-50. At page 65, Mr. Grate states:

> Then, in 1995, the FCC released an order that adopted the revenue requirement offset method for both long-term and short-term construction projects. [footnote omitted] Attached as Exhibit PEG-D3 is a copy of the order. The order explains why the FCC concluded the revenue requirement offset method is superior to the rate base and capitalization methods and is the best approach.

Have you reviewed the FCC order discussed by Mr. Grate?

A. Yes. I have carefully reviewed the FCC Report and Order ("FCC R&O")[15] attached as Exhibit PEG-D3 to Mr. Grate's direct testimony.

> In the Notice, we proposed the revenue requirement offset method for both short-term and long-term construction projects because we believed that this method would allow us to adopt accounting that is both consistent with GAAP and fair and reasonable for ratemaking purposes. Of the thirteen commenting parties, three support the proposal, [footnote omitted] and ten oppose it in varying degrees. [footnote omitted]
> [FCC R&O, par. 7 ]

In general, the FCC concluded that the revenue requirement offset method was the best approach for several reasons, including:[16]

- Consistency with GAAP for both long-term and short-term TPUC;
- Provides carriers with incentive to invest in new plant, because TPUC and AFUDC would be included in rate base;
- Allows carriers to earn a rate of return on total investment;
- AFUDC is included in determination of both rate base and current income for ratemaking purposes;
- Recognition of AFUDC in current income mitigates the increase in revenue requirement resulting from including all TPUC in rate base;
- Because other methods lack these advantages, the revenue requirement offset method is superior to the alternatives.

[15] Report and Order FCC 95-56, CC Docket No. 93-50, released February 28, 1995.
[16] FCC R&O, par. 10.

The FCC also cited as an advantage the fact that the revenue requirement offset method would allow carriers to earn the authorized rate of return on all investments in the telecommunications network as a result of rate base inclusion. Because of the revenue offset unique to this method, the FCC concluded that interstate ratepayers would pay very little for any new plant until the plant is placed in service.[17]

Q. Do you concur with the FCC's findings on this issue?

A. No. At paragraph 13 of the FCC R&O, the FCC observed, in part:

> We acknowledge that in our new policy with regard to all TPUC, as in our prior policy [footnote omitted] with regard to short-term TPUC, we depart from the used and useful standard by allowing carriers to place plant in the rate base prior to its being placed in service. We believe, however, that this limited additional departure from the used and useful standard will not harm the ratepayers because for carriers as a group during each of the first few years, the revenue offset will exceed the additional revenue requirement associated with the inclusion of long-term TPUC in the rate base. The ratepayers receive the benefits of reduced rates in the initial years of implementation. In future years, the increased return and depreciation expense resulting from the inclusion of plant under construction in the rate base could exceed the amount of interest capitalized. Then the total revenue requirement for carriers as a group would exceed the level that would occur under our present requirements. Although excluding all TPUC from the rate base, as MCI suggests, would avoid this effect, we believe that such an exclusion would be unfair to carriers and that the method we are adopting best balances ratepayer and carrier interests.

I disagree with the FCC's rationale on several key points for intrastate regulatory purposes. First, the used and useful standard is "key" to the matching concept often applied for ratemaking purposes, as discussed earlier, to avoid inherent distortions introduced into the revenue requirement formula. If for no other reason, the Commission should reject the Company's proposed rate base inclusion of TPUC, consistent with its past findings.

Second, the FCC relied on its assessment of the revenue requirement impact of the change to this method, which was believed to actually "reduce rates in the initial years of

[17] FCC R&O, par. 11.

implementation." Unfortunately for the Company's Arizona intrastate customers, the FCC's assessment does not portray the realities of Qwest's proposed adoption of this method. One must look no further than the Company's own quantification of the revenue requirement effect of its Adjustment PFA-04 to see that an immaterial amount of AFUDC revenues are dwarfed by the current return realized on the TPUC balance included in rate base – resulting in an increase to revenue requirement of about $4.1 million.[18] This result is contrary to the cited expectation of the FCC of reduced revenue requirements for carriers as a group.

Q. At the time the FCC was considering adoption of the revenue requirement method, did the Company expect reduced revenue requirements in the early years of adoption?

A. Apparently not. At paragraph 12 of the FCC R&O, the FCC expressed their disagreement with the assertions of the Florida PSC, BellSouth and Qwest (then US West) that the revenue offset method "should not be used because AFUDC accruals are immaterial." The FCC went on to address its view that "we would expect AFUDC accruals under our proposal to amount to nearly $400 million or approximately 3 percent of their total return." Further, the FCC stated that carriers would be encouraged to transfer investment from the TPUC account to plant in service, as "the revenue requirement offset method gives carriers the incentive to transfer plant from construction into service as promptly as possible to avoid AFUDC revenue requirement offsets."

In earlier reply comments filed by U S West Communications, Inc. (CC Docket No. 93-50) on May 28, 1993, the Company made several references to AFUDC materiality concerns and the need for flexibility, as noted in the following excerpts:

> U S WEST believes that carriers should be accorded the flexibility to decide whether to account for AFUDC under the revenue requirement offset method or not, depending on whether the accounting carrier makes a company-specific determination that AFUDC is immaterial. Such flexibility becomes increasingly more appropriate in light of the advent of new entrants and burgeoning competition in telecommunications. In such an environment, regulated carriers should be permitted to report their results of operations on a basis that is consistent with other companies operating in similar technological and competitive environments.

[18] Qwest spreadsheet "az1203_Revised 11-05-04.xls".

> It is not clear from the NPRM the extent to which the Commission would make mandatory the revenue requirement offset method of accounting, regardless of whether or not the amounts to be capitalized are material. [footnote omitted] U S WEST urges the Commission not to make the use of such method mandatory in all circumstances.
> [U S WEST Reply Comments, May 28, 1993, p.3]
>
> ...
>
> U S WEST supports the Commission's proposal to move to the revenue requirement offset method of accounting for AFUDC, with the caveat that the full significance of SFAS 34 be accorded Commission support. Thus, if a carrier deemed AFUDC not material enough to be accounted for under the revenue requirement offset method, it would be free to utilize a different accounting methodology, such as the rate base method.
> [U S WEST Reply Comments, May 28, 1993, pp.4-5; Original Emphasis]

Although I do not concur with the suggestion that the rate base method is a reasonable alternative, it is important to observe the Company's materiality concerns and its expressed interest in flexibility. In the pending Arizona docket, the Company is heavily relying on the FCC's final decision in CC Docket No. 93-50 as the principal basis for adopting the revenue requirement offset method.

**Company Analysis of AFUDC Alternatives**

Q. What AFUDC cost rate does Mr. Grate's simplified analysis use for the capitalization method?

A. Referring to Exhibit PEG-D4, Mr. Grate's analysis uses an authorized rate of return of 10% (debt & equity) and an AFUDC rate of 8% (average debt cost). Unfortunately, these assumed cost rates are inconsistent with the Company's proposed weighted cost of capital, do not reflect the actual AFUDC rates recently employed by Qwest in Arizona, and fail to recognize the gross-up for income taxes that result from rate base inclusion.

Q. What weighted cost of capital is Qwest proposing in the current proceeding?

A. Referring to Staff Schedule D, Qwest is proposing a weighted cost of capital of 11.18%, not 10%.

Q. What AFUDC rate has the Company been recently using in the capitalization of AFUDC for Arizona accounting purposes?

A. Qwest's response to Staff Data Request UTI 16-14(c) indicates that the AFUDC rate employed by the Company has been 9.75% -- the return authorized by the Commission in Docket No. E-1051-93-183.

Q. Why is the gross-up for income tax expense at all important in assessing the impact of these alternative methods?

A. In assessing alternative approaches, attention should be focused on the net present value of the change in overall revenue requirement attributable to the accounting alternatives proposed by the Company. Such analyses normally focus on life cycle assessments, which Mr. Grate's Exhibit PEG-D4 assumes to be a five-year period. Unfortunately, the cost to ratepayers of either rate base method (revenue requirement offset method or rate base method) is significantly understated from a revenue requirement perspective, as the equity component of the weighted cost of capital is materially understated. Referring to Staff Schedule E, page 2, the effective return (i.e., gross of tax return) proposed by Qwest in quantifying overall revenue requirement is about 14.8%, not the 11.18% weighted cost rate nor the 10% rate assumed in Qwest's analysis.

Q. Do you agree with Mr. Grate that his analysis is useful and instructive?

A. No. His analysis only demonstrates the obvious. Rate base inclusion of TPUC, or any asset, yields a current return and cash earnings to the Company – by definition. AFUDC, on the other hand, is intended to provide a mechanism for the Company to recover the cost of financing the construction of the asset while the assets are under construction. Once construction is complete and the asset is placed in service (i.e., used and useful), the capitalization of AFUDC ceases. Such capitalized costs are included in the cost of the asset included in rate base and recovered through the depreciation of the book basis of that asset. AFUDC is not and has never been intended to compensate the utility for the full return on investment during and after construction is complete.

In other words, Qwest appears to argue that any method of capitalizing AFUDC is deficient if it does not result in equivalent value to the Company as would inclusion of TPUC in rate base – which is the key element of both the rate base method and the revenue requirement offset method. In spite of this fundament deficiency, the analysis prepared by Mr. Grate quantifies a difference in the AFUDC methodologies that is not due to a deficiency in the capitalization method, but is an intended result of the capitalization method.

**Other Considerations**

Q. Do any other jurisdictions in which Qwest operates have TPUC regulatory policies that differ from the FCC?

A. Yes. According to Qwest's response to Staff Data Request UTI 16-13S1, the State jurisdictions of Colorado, Minnesota and Washington require a different TPUC methodology than the FCC. It appears that Colorado and Washington allow AFUDC to be capitalized on both long-term and short-term TPUC, but exclude TPUC from rate base – similar to Arizona. Minnesota does not allow AFUDC to be capitalized on short-term TPUC, but includes short-term TPUC in rate base.

Q. When did Qwest first adopt the revenue offset method for interstate accounting and regulatory purposes?

A. For FCC regulatory purposes, Qwest adopted this method in September 1995.[19]

Q. Did the Company propose the revenue requirement offset method in the last Arizona rate case, Docket No. T-1051B-99-105?

A. No. Even though the test year in the last rate case was based on calendar year 1999, the Company did not seek rate base inclusion of TPUC or the adoption of the revenue requirement offset method.

Q. At page 66 of his direct testimony, Mr. Grate describes carrier incentives in the context of the revenue requirement offset method, allowing carriers to earn a current return on

[19] Qwest response to Staff Data Request UTI 16-10.

TPUC expenditures. Has Qwest declined to invest in new plant in Arizona specifically due to the fact that TPUC has not historically been included in rate base for intrastate ratemaking purposes?

A. No.[20]

## PRO FORMA DEPRECIATION & RESERVE ADJUSTMENTS

Q. Please describe Staff Adjustments C-22, C-23 and B-7.

A. Staff Adjustment C-22 represents the annualization of depreciation expense based on the depreciable plant included in rate base and book depreciation rates adjusted to recognize the depreciation reserve balance at test year-end. Staff Adjustment C-22 is similar to Company Adjustment PFA-01, except Qwest's adjustment is based on depreciation rates that recognize depreciation reserve balances at the start of the test year. Staff Adjustment C-23 recognizes the pro forma effect of new depreciation accrual rates, based on Staff's revised "projection lives" and "future net salvage" recommendations. Collectively, these Staff adjustments represent the incremental change to the pro forma level of book depreciation expense included in Qwest's update filing of June 21, 2004, as proposed and sponsored by Staff witness Dunkel.

Qwest's update also included a rate base adjustment recognizing a pro forma depreciation reserve and deferred income tax reserve effect attributed to the decrease in depreciation expense associated with the Company's proposed technical update. Because Qwest will not commence booking any rate base effect associated with revised depreciation rates the Commission might approve until well beyond the 2003 test year, Staff Adjustment B-7 excludes the pro forma effect of any capital recovery adjustment from rate base (i.e., accumulated depreciation reserve and accumulated deferred income tax reserve).

Q. How were Staff Adjustments C-22 and C-23 quantified?

A. Book depreciation was annualized by multiplying the intrastate investment in depreciable plant included in rate base as of December 31, 2003, by the proposed accrual rates (i.e., by plant account) sponsored by Staff witness Dunkel. The aggregate amount of the pro

[20] Qwest response to Staff Data Request UTI 16-12.

forma depreciation was then compared to the sum of Qwest's annualization adjustments (Company Adjustments PFA-01 and PFN-11) and the amount of depreciation expense recorded in Account 6561 during the test year.[21]

Q. Why did you quantify the Staff Adjustments C-22 and C-23 in this manner?

A. In order to accurately quantify Staff's adjustment to the Company's June 21, 2004, updated filing, it was necessary to properly determine the amount of pro forma depreciation expense Qwest has included in its proposed operating results. Further, Staff's annualization of depreciation expense is based on the amount of intrastate depreciable plant included in rate base, as multiplied by the proposed depreciation rates recommended by Mr. Dunkel.

Q. How does the value of the Staff's proposed change in book depreciation rates compare to the change recommended by the Company?

A. Referring to the combination of Staff Adjustments C-22 and C-23, Staff's depreciation rate recommendation reduces intrastate depreciation expense (i.e., using the Staff's proposed depreciation accrual rates as applied to year-end 2003 depreciable plant) by approximately $140 million in addition to the Company's proposed reduction of about $104 million (Qwest Adjustments PFA-1 and PFN-11).

Q. Is the entire $244 million change in depreciation expense proposed by Company and Staff related solely to the change in book depreciation rates?

A. No. During 2003, the amount of book depreciation expense actually recorded by the Company is based on average depreciable investment. As the Company's investment in depreciable plant increases, so does the amount of related depreciation expense. Since Qwest has increased the level of depreciable investment during the test year (i.e., approximately $158 million according to Company workpapers underlying Adjustment PFA-01 and PFN-11), the annualization of depreciation expense on year-end investment

[21] In quantifying Staff Adjustment C-22 and C-23, special consideration was given to the recommended adjustments proposed by Mr. Dunkel for DSL assignment to interstate (Staff Adjustments B-3 & C-6) and the elimination of BSI related construction charges (Staff Adjustments B-4 & C-7) in order to ensure that the depreciation expense related to these items was not inadvertently eliminated twice or otherwise double-counted.

would be higher than recorded amounts – even if the Commission does not authorize any change in book rates. So, the $244 million decrease in depreciation has been offset, in part, by additional depreciation related to the test year growth in depreciable plant.

Q. Why do you believe that it would not be appropriate to reflect the annual effect of the proposed depreciation rate decrease in the quantification of rate base?

A. While the annualization of depreciation expense for ratemaking purposes should synchronize the new depreciation rates with the level of depreciable plant included in rate base, the depreciation reserve used as an offset to rate base should be determined consistent with the balance of plant in service included in rate base. In other words, the balance of both of these rate base components in Staff's filing should be valued at December 31, 2003 – as appropriately adjusted for eliminations, corrections or other valuation issues. In my opinion, the Commission should <u>not</u> reach out beyond test year-end to capture, in isolation, the full pro forma annual effect of the change in depreciation rates on the December 31, 2003, year-end balances for the accumulated depreciation reserve and the accumulated deferred income tax reserve. Otherwise, test year distortions and mismatched components of the ratemaking equation would yield improper results.

Q. As a result of reversing Qwest's pro forma effect on the accumulated depreciation reserve and the accumulated deferred income tax reserve, did Staff Adjustment B-7 have the effect of increasing or decreasing overall revenue requirement?

A. As indicated on Staff Schedule E, Staff Adjustment B-7 decreases intrastate rate base, thereby decreasing revenue requirement by about $7.6 million, based on Staff's proposed capital structure and cost rates.

Q. Have you proposed similar adjustments to rate base in past cases, reversing Company's rate base adjustments tied to pro forma changes in book depreciation expense?

A. Yes. I have sponsored testimony and a similar rate base reversal adjustment in the Company's last rate case (Docket No. T-1051B-99-0105), even though that Staff adjustment had the effect of increasing both rate base and overall revenue requirement.

**DSL – REMOVED FROM INTRASTATE**

Q. Please describe Staff Adjustments B-3 and C-6.

A. Staff Adjustments B-3 and C-6 represent the removal of DSL[22] net investment and related operating expenses from the intrastate jurisdiction. These adjustments are based on the corrections set forth on confidential Schedule WDA-15, sponsored by Staff witness Dunkel, and incorporate those recommendations into Staff's overall revenue requirement recommendation.

Q. Are any other Staff adjustments affected by Staff Adjustments B-3 or C-6?

A. Yes. One component of Staff Adjustment C-6 removes DSL related book depreciation from the intrastate jurisdiction. Since Staff has separately annualized book depreciation expense based on the intrastate depreciable plant included in rate base (i.e., net of the DSL assignment) using the proposed depreciation accrual rates sponsored by Staff witness Dunkel,[23] it is necessary to integrate Staff's DSL recommendations with that annualization of book depreciation so as to avoid any double counting of the depreciation and plant assignment.

Referring to Staff Adjustments C-22 and C-23, DSL investment has been excluded from the balance of intrastate depreciable plant for purposes of quantifying the pro forma depreciation effect of Staff's recommended accrual rates. In order to avoid removing DSL depreciation from the intrastate jurisdiction twice, the depreciation expense component of Staff Adjustment C-6 is added back on line 34 of Schedule C-22.

Q. Why did you quantify Staff Adjustments C-6 and C-22 in this manner?

A. This format accomplishes two purposes. First, Staff Adjustment C-6, in conjunction with Staff Adjustment B-3, represents a stand-alone quantification of the DSL removal recommended by Mr. Dunkel. Second, Staff Adjustment C-22 recognizes the interrelationship that exists between the two DSL adjustments and the annualization of

[22] As discussed in the direct testimony of Staff witness Dunkel, DSL is a broadband/wideband Internet transport service used for internet access and provided by Qwest.

[23] Staff Adjustments C-22 and C-23.

book depreciation expense, using Staff's proposed accrual rates that are different from those in effect during the test year.

## BSI – CONSTRUCTION RELATED CHARGES

Q. Please describe Staff Adjustments B-4 and C-7.

A. Staff Adjustments B-4 and C-7 represent the proposed elimination of certain net investment and related depreciation expenses attributable to BSI construction related charges.[24] These adjustments are based on the proposed adjustments summarized on confidential Schedule WDA-18, sponsored by Staff witness Dunkel, and incorporate those recommendations into Staff's overall revenue requirement recommendation.

Q. Are any other Staff adjustments affected by Staff Adjustments B-4 or C-7?

A. Yes. Staff Adjustment C-7 removes test year book depreciation related to the construction charges that should have been paid for by BSI, as discussed by Mr. Dunkel. Since Staff has separately annualized book depreciation expense based on the intrastate depreciable plant included in rate base (i.e., net of the BSI elimination) using the proposed depreciation accrual rates also sponsored by Staff witness Dunkel,[25] it is necessary to integrate Mr. Dunkel's BSI recommendations with the annualization of book depreciation so as to avoid any double counting of the depreciation and plant assignment.

Referring to Staff Adjustments C-22 and C-23, BSI investment has been excluded from the balance of intrastate depreciable plant for purposes of quantifying the pro forma depreciation effect of Staff's recommended accrual rates. In order to avoid removing the BSI construction related depreciation twice, the depreciation expense component of Staff Adjustment C-7 is added back on line 34 of Schedule C-22.

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[24] As discussed in the direct testimony of Staff witness Dunkel, BSI (a Qwest affiliate) uses certain Qwest facilities to provide ADSL TV and other services, including certain cabinet locations built specifically to serve the needs of BSI.

[25] Staff Adjustments C-22 and C-23.

Q. Why did you quantify Staff Adjustments C-7 and C-22 in this manner?

A. This format accomplishes two purposes. First, Staff Adjustment C-7, in conjunction with Staff Adjustment B-4, represents a stand-alone quantification of the BSI construction charge issue addressed by Mr. Dunkel. Second, Staff Adjustment C-22 recognizes the interrelationship that exists between the two BSI adjustments and the annualization of book depreciation expense, using the Staff's proposed book rates that are different from those in effect during the test year.

## YEAR-END WAGE & SALARY ANNUALIZATION

Q. Please describe Staff Adjustment C-16.

A. Staff Adjustment C-16 revises test year basic wages and salaries by consistently recognizing, or matching, ongoing Arizona employee counts with the effective salary levels and wage rates at test year-end.

Q. Did the Company propose a pro forma adjustment to annualize salaries and wages to test year-end levels?

A. No. However, the Company's filing does include an adjustment (i.e., Adjustment PFN-05)[26] to annualize the effect of certain pay increases granted in the first quarter of 2003. In the Company's last rate case (Docket No. T-1051B-99-105), Qwest did present a payroll annualization adjustment that considered, in part, year-end employee or headcount levels.

Q. Did Company Adjustment PFN-05 recognize the effects of any decline in test year headcounts?

A. No. As discussed by Mr. Grate,[27] the Company "found no statistically valid trend in employee levels over time." Citing to Exhibit PEG-D6 attached to his direct testimony, Mr. Grate states:

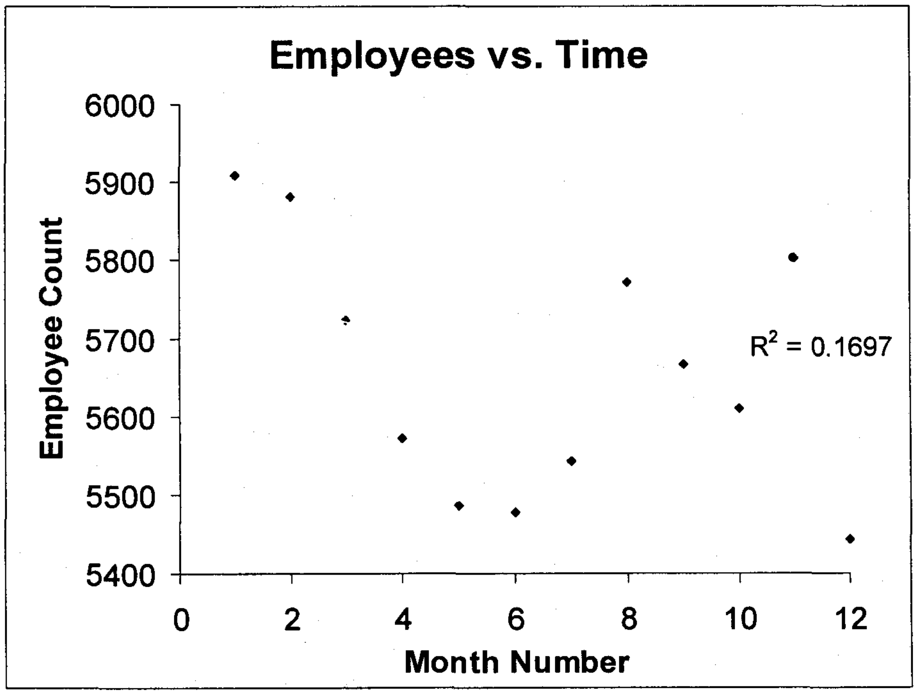
> The R-Squared of the independent variable (time) to the dependent variable (employee count) was only 0.114 and the T-Score was 1.13, indicating an absence of any statistically meaningful and reliable

26 Grate direct testimony, p. 92.
27 Grate direct, p. 92.

relationship. In other words, the variability in the level of employees over the course of the test year does not support the hypothesis that the employee count at the end of the test year is more realistic or representative of ongoing conditions than the count during the test year as a whole. Accordingly, I made no adjustment for end-of-period employee levels.[28]

Mr. Grate's revised PEG-D6, provided in the non-confidential response to Staff Data Request UTI 2-2, is reproduced below for reference purposes:

**Qwest Arizona**
**2003 Employee Levels**




Q. If the test year employee trend is as poor as depicted by Mr. Grate, why should pro forma wage expense recognize employee counts at test year-end?

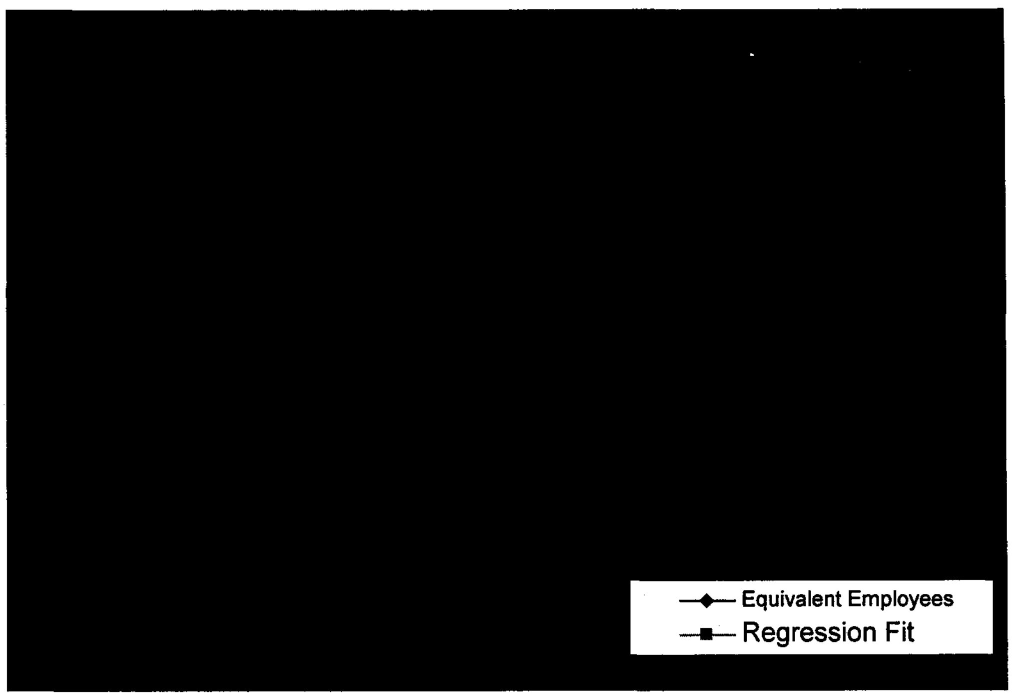
A. On first impression, it would appear that test year equivalent headcount levels, as set forth on revised PEG D-6, were sporadic and would not support the need for any significant employee annualization adjustment. However, after reviewing employee

[28] In response to Staff Data Request UTI 2-22, PEG-D6 was revised to reflect minor revisions in equivalent headcounts for October-December 2003, increasing the coefficient of determination (R-Square) from 0.114 to 0.1697.

trends prior to and subsequent to the test year, the data indicates that the "uptick" in headcounts shown on PEG D-6 for months of August - December 2003 was aberrational.

Q. Could you describe the recent historical trend in employee levels, continuing through and subsequent to the test year?

A. Yes. The following chart represents the historical trend in Qwest's actual equivalent headcounts from January 2001 through December 2003, including post-test year levels for comparative purposes. While equivalent headcounts can and do vary from month to month, like the increase in late 2003 that contributed to the Company's calculation of a poor 0.1697 R-Squared statistic, Qwest has exhibited a decidedly downward trend in headcounts since January 2001. In addition to actual monthly equivalent headcounts, the following chart also depicts the smoothed headcount trend resulting from a 36-month regression analysis (January 2001 through December 2003), using the linear regression technique employed in the Company's test year headcount analysis as well as in analyzing and annualizing test year revenues and expenses:




Although the "uptick" in late 2003 is clearly observable on this chart, the 36-month linear regression yields a statistically significant 0.8661 R-Squared, showing a strong correlation between time and equivalent headcounts – unlike the 0.1697 (revised) R-

Squared resulting from the twelve test-year data points. The "regression fit" line on the chart represents the 36-month regression results, which smooth the month-to-month data variations. The headcount estimate for the terminal month (i.e., December 2003) was used in quantifying Staff Adjustment C-16 so as to remove the aberration in employee levels in late 2003. Clearly, the regression fit trend line better reflects the historical trend in observed levels and fits relatively well with actual post-test year equivalent headcounts.

Q. Did you rely on the regression results to determine year-end headcounts for purposes of annualizing basic payroll?

A. Yes, in part. Consistent with the annualization adjustment I proposed in Qwest's last rate case (Docket No. T-1051B-99-105), Staff Adjustment C-16 is based on average regular pay (basic pay plus paid absences) per equivalent employee (i.e., both management and occupational employees) for the months of October through December 2003. Because of the aberration in December 2003 employee levels, the "regression fit" employee count for December 2003 was multiplied by the three-month average pay per employee and then multiplied by an annualization factor of twelve (12). This methodology consistently recognizes the annual effect of any wage and salary changes implemented during the test year with a reasonable valuation of year-end employee levels.[29]

Q. Since Company Adjustment PFN-05 has a negligible impact on test year wage and salary costs, how does Staff's proposed level of basic wages and salaries compare with recent actual levels?

A. The following table compares the basic wage and salary costs[30] incurred in 2001, 2002 and 2003 with Staff's pro forma level:

[29] This Staff annualization technique is comparable to the methodology used in the last rate case, but for the reliance on linear regression results.

[30] Sum of basic wages and salaries plus paid absences on a Total Arizona basis, before distribution between expense and capital accounts.

| (millions) | Qwest – Arizona Basic Wages & Salaries[31] | | |
|---|---|---|---|
| | Total State | Change | % Change |
| 2001 | [redacted] | | |
| 2002 | [redacted] | [redacted] | [redacted] |
| 2003 | [redacted] | [redacted] | [redacted] |
| Staff Pro Forma | [redacted] | [redacted] | [redacted] |

Source: Qwest confidential response to Staff Data Request UTI 9-4 & Staff Adjustment C-16.

As indicated by this table, Staff's proposed level of basic salaries and wages compares favorably with recent experience – in terms of both dollar and percentage reductions. In spite of continued headcount declines and reduced basic wage and salary levels, Qwest has essentially presumed that actual test year expense reasonably represents ongoing levels.

Q. Could you briefly explain the reference to "equivalent" employees or headcounts?

A. Yes. Qwest's employee workforce is distributed at work locations throughout a fourteen state region. Due to the nature of the work an individual employee might perform, the payroll and benefit costs of that employee could be assigned directly to the Company's operations in the State in which the employee is physically located or could be allocated between multiple State operations. Headcounts based on the geographic location (e.g., Arizona) of the employee are referred to as "situs" employees. If 100% of a particular employee's time was directly assigned to the State in which he/she was physically located, this employee would be counted as one "situs" employee as well as one "equivalent" employee.

The difference between "situs" and "equivalent" employees comes into play when the payroll and benefit costs of certain employees are allocated to or distributed between the operations of more than one State. Since payroll costs are typically allocated between

[31] Source: Qwest confidential response to Staff Data Request UTI 9-4, basic wages and salaries plus paid absences.

multiple States, the Company determines Arizona's "equivalent" employee count based on the relationship of Arizona's salaries and wages to Total Qwest Corporation salaries and wages to allocate Total Qwest Corporation "situs" employee levels. So, an employee located in Arizona and partially allocated to other States would be viewed as one "situs" employee in Arizona, but less than one Arizona "equivalent" employee.

## INCENTIVE COMPENSATION

Q. Is Staff proposing an adjustment to the test year amount of incentive compensation expense Qwest has included in revenue requirement?

A. Yes. In quantifying overall revenue requirement, Qwest Adjustment PFN-08 decreased the amount of incentive compensation accrued during the test year to reflect the actual bonus amounts paid in 2004 for the 2003 plan year.[32] Staff Adjustment C-17 represents a partial disallowance of test period incentive compensation expense Qwest has recognized in quantifying overall revenue requirement. Staff proposes to eliminate the incentive costs associated with the financial components of Qwest's incentive compensation plan, while allowing ratemaking recovery of test period expense associated with the customer satisfaction components. After Staff's proposed adjustment, the test period will include approximately [redacted] of incentive compensation expense (intrastate).

Q. Please describe the incentive program offered by the Company.

A. In prior Arizona proceedings, the Company had maintained various long-term and short-term incentive plans, which are no longer offered. During 2003, Qwest had only one incentive compensation plan (the "Bonus Plan" or "Bonus Award") for eligible employees. The Bonus Plan was offered to employees of Qwest Corporation, Qwest Services Corporation and Qwest Communications International Inc. ("QCII").[33] As presented to the Board of Directors, the philosophy of Qwest's Bonus Plan was stated as follows:[34]

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32 Qwest response to Staff Data Request UTI 2-29S1.
33 Qwest response to Staff Data Request UTI 8-36.
34 Qwest response to Staff Data Request UTI 1-31S1, Confidential Attachment C.

[redacted]

Q. Please briefly describe the various components of the incentive compensation program.

A. The Bonus Plan is based on three components: [redacted]

| | Weighting Factor | % Payout | Weighted Payout |
|---|---|---|---|
| [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] |

[redacted]

Source: Qwest confidential response to Staff Data Request UTI 1-31.

[redacted].[35]

Q. How did you quantify Staff Adjustment C-17?

A. As shown by the above table, the Bonus Plan is heavily weighted to [redacted] targets and objectives. For example, [redacted]. Conservatively, Staff Adjustment C-17 allows [redacted]% of test year incentive compensation payments charged to operating expense.

Q. How does the amount of incentive compensation Qwest has proposed to recover in this proceeding compare to the amounts incurred in recent years?

A. Recognizing that Company witness Grate proposes to adjust the Bonus Plan accruals recorded during the test year to the actual amount paid in 2004 for the 2003 plan year, the actual test year expense level is higher than the amount Qwest has included in overall revenue requirement. The following table compares the historical level of incentive compensation costs with the levels proposed by both Qwest and Staff.

[35] Qwest response to Staff Data Request UTI 1-31, Confidential Attachment D.

**Intrastate**

| Year | Paid | Accrued (d) |
|---|---|---|
| 2001 – Plan Year (a) | [redacted] | [redacted] |
| 2002 – Plan Year (b) | [redacted] | [redacted] |
| 2003 – Plan Year (c) | [redacted] | [redacted] |
| 2003 – Qwest Proposed | | [redacted] |
| 2003 – Staff Proposed | | [redacted] |

Source: Qwest confidential response to Staff Data Request UTI 20-4 & confidential Staff Adjustment C-17.

[redacted]

Q. Why have you proposed to disallow a significant portion of the test year incentive plan cost?

A. There are several reasons why this adjustment is appropriate. First, a significant portion of the Bonus Plan focuses on the corporate-wide financial results of Qwest Communications International, Inc. ("QCII"). Those Company employees directly or indirectly supporting the provision of telecommunications service in the State of Arizona have limited ability or opportunity to materially affect the consolidated financial results of QCII. Efforts to enhance consolidated financial results may not be consistent with the interests of Qwest's Arizona customers or reasonable pricing of regulated service offerings, recognizing that any revenue requirement finding in this proceeding may not translate into revised rates charged Arizona customers.

Second, the consolidated <u>financial</u> targets are not linked to customer service, employee safety, cost reductions or operational achievements or efficiencies in Qwest's Arizona service territory.

Third, to the extent that the inclusion of financial targets in the Bonus Plan assists Qwest in achieving improved financial results, the cost of the Company's discretionary bonus plan should be funded by the increased levels of net income, cash flow and other financial resources, rather than through the revenue requirement that could be used to support prices charged to Qwest's Arizona customers.

Obviously, a decision by management to incur incentive compensation costs is an indication that such costs were viewed as reasonable by the Company, but regulators need not allow above-the-line accounting for all discretionary costs incurred by management absent a showing that such costs provide direct, tangible benefits to ratepayers. With this in mind, Staff proposes recovery of the test year Bonus Plan costs reasonably allocable to service quality measures.

Q. Please explain the focus of the financial components of Qwest's 2003 Bonus Plan.

A. The financial targets of the 2003 Bonus Plan are based on consolidated results for Qwest Communications International, Inc. The following response to Staff Data Request UTI 12-4 provides the rationale for the linkage to the consolidated financials:

> Qwest does not budget at the entity level. Qwest's financial objectives are at a total Company (or QCII) level and/or Business Unit level (i.e., Consumer Markets, Business Markets). Compensation targets are tied to these objectives regardless of to what entity an employee's labor costs are allocated. The effect of tying incentive compensation costs to QCII level and Business Unit level performance cuts both ways: employees whose costs are charged to regulated operations are compensated based on QCII results (which include non-regulated operations) and employees whose labor is not charged to regulated operations are also compensated based on QCII's total operations (which also include regulated operations). The effect is that all employees are compensated in part based on the performance of regulated operations (regardless of where their time is charged) and all employees are compensated in part based on the performance of non-regulated operations (again regardless of where their time is charged).
> [Qwest response to Staff Data Request UTI 12-4]

Q. How do the consolidated financial results of QCII compare over the past several years?

A. The QCII 2003 Form 10-K filed with the Securities and Exchange Commission for calendar 2003 contains detailed financial information, including the following historical income information:

Qwest Communications International, Inc.
Consolidated Financials

| **Millions** | Net Income (Loss) | Loss from Continuing Operations |
|---|---|---|
| 2001 | $ (5,603) | $ (6,117) |
| 2002 | (38,468) | (17,618) |
| 2003 | 1,512 | (1,313) |

Source: QCII 2003 SEC Form 10-K, pp. 34 & 75.

During each of these three calendar years, QCII recorded asset impairment charges pursuant to FAS144, Accounting for the Impairment or Disposal of Long-Lived Assets. According to notes accompanying the QCII consolidated financial statements, the magnitude of the loss reported in 2002 is attributable to the recording of significantly larger asset impairment charges, as compared to 2001 and 2003.[36]

Q. In 2003, the reported loss from continuing operations is negative, while QCII reported positive net income for the year. What caused this difference?

A. In 2002 and 2003, QCII recorded significant gains on the sale of its directory publishing business as well as income from those discontinued operations. Although QCII reported a $2.6 billion gain related to this sale in 2002 (before income taxes), the 2002 gain was overshadowed by much larger impairment charges. But for the gain from the directory sale, QCII would have also reported a net loss in 2003, as indicated by the $1.3 billion loss from continuing operations.

Q. Did the 2003 Bonus Plan use the consolidated net income as one of the financial components to determine payouts under the plan?

A. Yes.

Q. Since continuing operations reported a net loss for 2003 absent the sale of the directory publishing business, why would any incentive payments for the 2003 plan year?

[36] Source: QCII 2003 SEC Form 10-K, pp. 42, 62, 88 & 91-92.

A. That very question was posed to Qwest as Staff Data Request UTI 13-1(a). The Company responded as follows:

> The financial targets established for the 2003 Bonus Plan anticipated the close of DEX West and its effect on revenues, net income and cash flow. Had the sale not closed, it is likely the compensation committee would have approved revising the targets to remove the anticipated sale because whether or not it closed was not a matter upon which the employees could have any substantial effect.
> [Staff Data Request UTI 13-1(a)]

Absent the Dex West sale, it would seem somewhat of a challenge to fashion incentive payouts around QCII's consolidated financials that reported a rather large net loss for the year. In response to Staff Data Request UTI 13-1(b), the Company addressed, in part, why employees should receive a bonus for 2003 even if net income had been negative absent the Dex West sale:

> ...The bonus plan is not a profit sharing plan were employees receive a portion of net income. Instead, it is an incentive plan where the targets must be established in a way that helps to encourage desired behaviors and financial results. Setting unrealistic targets that require positive net income in the current economic and competitive environment would not prove useful for motivating positive behavior and might, instead, contribute to employee dissatisfaction.
> [Staff Data Request UTI 13-1(b)]

This line of thought seems to indicate that incentive targets or objectives should be established based on parameters that employee actions or inactions could have a substantial effect in attaining or missing. As designed, it is difficult to envision how the employees supporting Qwest's Arizona operations could have a substantial influence on achieving the consolidated financial results of QCII.

Q. Earlier, you stated that "regulators need not allow above-the-line accounting for all discretionary costs incurred by management absent a showing that such costs provide direct, tangible benefits to ratepayers." Could you further elaborate on this statement?

A. Yes. In considering amendments to Part 65 of the FCC rules prescribing the components of rate base and net income for dominant carriers, the FCC discussed the framework surrounding its proposed changes.

> 7. In developing our proposal, we were guided by two historically applied principles – the "used and useful" standard and the benefit-burden test.

> The "used and useful" standard denotes property dedicated to the efficient conduct of a utility's business, presently or within a reasonable period. That standard reflects the principles that owners of public utilities must receive an opportunity to be compensated for the use of their property in providing a public service and that ratepayers must not be forced to pay a return on investment that does not benefit them directly. The benefit-burden test is based on the principle that the party who bears the financial burden of a particular utility activity should also reap the benefits resulting therefrom. We proposed to apply these two general principles to specific assets and asset categories established in Part 32 of our Rules, which will become effective January 1, 1988. [footnote omitted][37]

Although incentive compensation is only partially allocable between capital and expense accounts, Staff's approach follows the conceptual framework of the "benefit-burden" test. In other words, the party who benefits from a particular transaction or activity should bear the related financial burden. If ratepayers have not benefited from the achievement of the Bonus Plan incentive targets (consolidated financial results) or Arizona allocable employees can not substancially contribute to achieving those results, ratepayers should not be responsible for that portion of the cost of the Bonus Plan (incentive costs related to consolidated financial results).

Q. How does the amount of test year incentive compensation expense compare to Qwest's basic wages and salaries, excluding incentive compensation?

A. According to the confidential responses to Staff Data Request 2-24, Qwest's basic wages and salaries and overtime pay for the test year is about [redacted] (Total Arizona before jurisdictional separation). In comparison, the Company's test year incentive compensation expense of about [redacted] (Total Arizona before jurisdictional separation)[38] represents additional employee compensation of about [redacted]%, on average.

Incentive compensation is a method of providing monetary awards to the work force through unguaranteed bonus, or other payment program, in addition to base wages. Incentive compensation plans are typically designed to attract, retain and motivate employees, enhance teamwork and high levels of achievement, and to facilitate the

[37] CC Docket No. 86-497, FCC Report and Order, released December 24, 1987, par. 7.
[38] Qwest confidential responses to Staff Data Request UTI 9-3 and RUCO 6-1 indicate net incentive compensation for the 2003 plan year of $[redacted] (accrued in 2003) and negative $[redacted] (true-up recorded in 2004.

accomplishment of specific corporate, business unit and individual goals. By linking employee compensation to predetermined targets or objectives, individual employees are theoretically incented to perform well by directly influencing their day-to-day actions and activities – because if they do not achieve the target levels, they will not receive incentive compensation pay.

Based on largely unadjusted test year data, Qwest's cost of service recognizes that employees could receive, on average, an additional [redacted]% of at-risk, ratepayer funded compensation above and beyond their base wages/ salaries and overtime pay. The potential for indirect shareholder incentives do not directly influence the day-to-day actions and activities of individual employees. Instead, it is, or should be, the risk of losing the additional [redacted]% of compensation that will sufficiently incent an employee to help the Company achieve its targets and goals.

Q. If employees fail to achieve the corporate targets or individuals goals, will shareholders be required to forego all benefits associated with the incentive plans?

A. No. Since incentive compensation is "at-risk" to the employee, the amount of such compensation from year to year is not fixed, regular nor even certain to occur. In the event that minimum targets are not met, employees do not receive incentive payments and the amount of incentive compensation included in rates (e.g., Qwest has sought recovery of about [redacted] of incentive pay, excluding affiliate allocations and before jurisdictional separation) would contribute to increasing utility profits. In other words, ratepayers would be placed at-risk to fund incentive plan costs regardless of payout while employees are at-risk because targets might not be achieved for any number of reasons. At the same time, neither the Company nor its shareholders would necessarily be at-risk with respect to the [redacted] of total incentive pay included in test year expense, because the allowed expenses would be recovered through rates, regardless of future payouts.

Q. Since Staff Adjustment C-17 proposes to reduce test year incentive compensation expense, would this same theory apply to the remaining costs?

A. Yes.

Q. Does the Bonus Plan represent a binding commitment from Qwest?

A. No, I do not believe so. With regard to the 2003 Bonus Plan, the confidential response to Staff Data Request UTI 1-31, Attachment D, states: "[redacted]."

**SOP 98-1 (Internal-Use Software)**

Q. Please describe Staff Adjustments B-6 and C-11.

A. Staff Adjustment C-11 recognizes the pro forma effect of adopting for regulatory purposes, in the 2003 test year, a 1998 change in accounting for the cost of computer software developed or obtained for internal use. This adjustment reflects a five-year amortization of test year software costs transferred from expense to capital accounts and effectively eliminates the portion of Qwest's revised Adjustment PFA-03 that seeks to amortize pre-test year software costs that have not been previously capitalized for Arizona regulatory accounting purposes.

Since the Arizona regulatory adoption of SOP 98-1 recognized by Staff Adjustment C-11 is prospective in nature, Staff Adjustment B-6 reduces rate base to eliminate all plant in service, depreciation reserve and deferred income tax reserve effects improperly imputed by Qwest's revised Adjustment PFA-03. In essence, the Company's revised adjustment would set rate base as if SOP 98-1 had been adopted for Arizona regulatory purposes in 1999. Because that presumed adoption has not and did not occur, it would be improper to include those amounts in rate base.

Q. Please describe this accounting change.

A. Beginning at page 57 of his direct testimony, Mr. Grate describes Statement of Position 98-1 ("SOP 98-1") issued by the American Institute of Certified Public Accountants on March 4, 1998. Basically, SOP 98-1 changed the accounting guidance on the cost of internal use software from expensing in the current period to the capitalization and amortization of such costs. As indicated by Mr. Grate, Qwest adopted SOP 98-1 in 1999 and has recognized such accounting in its external financial statements since that time. However, Qwest has not adopted SOP 98-1 in any State jurisdiction other than Oregon for regulatory purposes.[39]

The following discussions, which appear in Qwest's (formerly USWC's) 1998 and 1999 SEC Form 10-K Annual Reports, provide concise summaries of this accounting change and the related effects on the Company's results of operations:

> <u>**1998 SEC 10-K**</u>
> On January 1, 1999, we adopted the accounting provisions required by the American Institute of Certified Public Accountants' Statement of Position ("SOP") 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," issued in March 1998. SOP 98-1, among other things, requires that certain costs of internal use software, whether purchased or developed internally, be capitalized and amortized over the estimated useful life of the software.
>
> Based on information currently available, adoption of the SOP may result in an initial increase in net income in 1999 of approximately $100-$150 [million]. In periods of adoption, if software expenditures remain level, the impact on earnings will decline until the amortization expense related to the capitalized software equals the software costs expensed prior to the accounting change.
> [USWC 1998 SEC Form 10-K, p.16]
>
> <u>**1999 SEC 10-K**</u> [all amounts in millions]
> COMPUTER SOFTWARE. On January 1, 1999, we adopted the accounting provisions required by the American Institute of Certified Public Accountants' Statement of Position ("SOP") 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use". SOP 98-1, among other things, requires that certain costs of internal use software, whether purchased or developed internally, be capitalized and amortized over the estimated useful life of the software. Capitalized computer software costs of $544 and $180 at December 31, 1999 and 1998, respectively, are recorded in property, plant and equipment and other assets – net. Amortization of capitalized computer software costs totaled $104, $82 and $78 in 1999, 1998 and 1997, respectively.
> [USWC 1999 SEC Form 10-K, p. F-6, FreeEdgar.com]

[39] Grate direct, pp. 57-58.

All non-governmental entities were required to implement this accounting change for fiscal years starting after December 15, 1998. Accordingly, the Company adopted SOP 98-1 on January 1, 1999, for financial reporting purposes, but has not yet adopted this accounting method in any State jurisdiction other than Oregon for regulatory accounting purposes.

Q. Why did SOP 98-1 require the capitalization and amortization of the cost of internal use software?

A. According to the Accounting Standards Executive Committee, the SOP 98-1 project was undertaken because of inconsistent accounting for software costs. The following historical information was extracted from the Introduction and Background section of SOP 98-1:

> 1. The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased or Otherwise Marketed*, in 1985. At that time, the FASB considered expanding the scope of that project to include costs incurred for the development of computer software for internal use. The FASB concluded, however, that accounting for the costs of software used internally was not a significant problem and, therefore, decided not to expand the scope of the project. The FASB stated that it recognized that at that time the majority of entities expensed all costs of developing software for internal use, and it was not convinced that the predominant practice was improper.
>
> 2. Because of the absence of authoritative literature that specifically addresses accounting for the costs of computer software developed or obtained for internal use and the growing magnitude of those costs, practice became diverse. Some entities capitalize costs of internal-use computer software, whereas some entities expense costs as incurred. Still other entities capitalize costs of purchased internal-use computer software and expense costs of internally developed internal-use computer software as incurred.
>
> 3. The staff of the Securities and Exchange Commission (SEC) and other interested parties have requested that standard setters develop authoritative guidance to eliminate the inconsistencies in practice. In a November 1994 letter, the Chief Accountant of the SEC suggested that the Emerging Issues Task Force (EITF) develop that guidance. However, the EITF and the Accounting Standards Executive Committee (AcSEC) agreed that AcSEC should develop the guidance.
> [SOP 98-1, p.7]

In addition to improving the comparability of financial data between entities, AcSEC expressed the belief that:

> ...the costs of computer software developed or obtained for internal use are specifically identifiable, have determinate lives, relate to probable future economic benefits (FASB Concepts Statement No. 6), and meet the recognition criteria of definitions, measurability, relevance, and reliability (FASB Concepts Statement No.5).
> [SOP 98-1, par.64]

Q. Has the FCC adopted SOP 98-1 for interstate regulatory purposes?

A. Yes. In an order issued on June 30, 1999, the FCC adopted SOP 98-1.

Q. Why are you recommending that the ACC adopt capitalization accounting for internal use software for Arizona regulatory purposes?

A. In general terms, costs which relate solely to the current period should be expensed as incurred. Costs incurred during the current year that relate to prior years should also be expensed. However, those costs that provide identifiable benefits or otherwise relate to more than one future period should be capitalized and amortized over the expected benefit period. Internal-use software does produce identifiable benefits for multiple future periods. As such, the cost of such software should be capitalized and amortized as specified by SOP 98-1.

It merits comment, however, that the mere recognition of a cost as a current period expense does not necessarily equate to inclusion in rates. For example, the regulatory process typically eliminates operating expenses associated with prior periods. Similarly, the level of certain costs recorded as expense in a particular test year may be abnormal (i.e., too high or too low), thereby requiring normalization adjustments to reflect reasonable ongoing levels.

Q. During 1999, did Qwest account for the cost of internal-use software differently in its financial accounting records than in its regulatory accounting records?

A. Yes. For financial accounting purposes, the Company capitalized the cost of internal-use software costs, consistent with SOP 98-1 as noted in the earlier SEC 10-K excerpts. At that time, the Company continued to expense the costs of internal-use software in its regulatory books of accounts. However, following the FCC's adoption of SOP 98-1, the Company similarly modified its accounting for the interstate portion of its regulated operations to reflect this change in capitalization, but continued to expense the portion of those same costs allocated to its Arizona intrastate operations.

Q. Could you explain how the Company can use different accounting treatments for the same item in its accounting records?

A. Yes. Qwest maintains and reports its financial results using accounting methods that may treat certain transactions differently for financial reporting, FCC reporting and State regulatory reporting purposes. In fact, regulatory reporting may differ between State jurisdictions, based on individual regulatory requirements. The Company's financial reporting records are maintained on what is generally referred to as an "FR" (or financial reporting) basis, consistent with Generally Accepted Accounting Principals (or "GAAP"). The Company's regulatory financial results are initially prepared and maintained consistent with FCC accounting requirements. These results are generally identified as being presented on an "MR" basis. Any differences in accounting treatments or requirements that exist between the FCC and each State regulatory agency are accounted for in the Company's "offbook" or side records, thereby allowing for specific tracking and consideration of these differences in State regulatory proceedings. The Company's "JD" reports reflect the accounting presentation that incorporates any "jurisdictional" accounting differences with the FCC and is consistent with State accounting requirements. While it is not as complicated as it may seem, Qwest has adopted SOP 98-1 and accounts for the capitalization of internal-use software for both "FR" and "MR" accounting purposes, but continues to expense these costs for "JD" accounting purposes in Arizona, absent a Commission decision adopting SOP 98-1 for intrastate regulatory purposes.

Q. Why does the Company report its operating results to the financial community on a different basis than is reported to the FCC?

A. As indicated in USWC's 1993 annual report to the Securities and Exchange Commission (SEC 10-K), the Company incurred a non-cash, extraordinary charge of $3.0 billion, net of income taxes, in conjunction with its decision to discontinue accounting for its operations in accordance with Statement of Financial Accounting Standards No. 71 (FAS71), "Accounting for the Effects of Certain Types of Regulation." The Company's decision to discontinue the application of FAS71 "was based on the belief that competition, market conditions and the development of broadband technology, more than prices established by regulators, will determine the future revenues of the Company." As a result of this change, the operating results reported to the financial community began to diverge from the results reported for regulatory purposes, because the Company's regulatory accounting and reporting methods were not affected by this change. So, the Company began maintaining different accounting records for financial reporting purposes than for regulatory purposes.

Q. The earlier quotes from the Company's 1998 and 1999 SEC 10-Ks, indicated that the adoption of the SOP 98-1 would result in increased net income during 1999. Has the Company proposed to reflect the Arizona share of this increase in net income in its proposed revenue requirement?

A. Yes and no. In direct testimony, Mr. Grate sponsored Adjustment PFA-03, representing Qwest's first ever recommendation that SOP 98-1 be adopted for Arizona regulatory purposes.[40] However, according to the response to Data Request UTI 4-1S1, Mr. Grate has revised his position and now concludes that Qwest should have adopted SOP 98-1 in 1999. As a consequence, Mr. Grate proposes to revise Adjustment PFA-03 from recognizing the pro forma affect of adopting SOP 98-1 in the 2003 test year (decreasing revenue requirement by $12.7 million) to adoption in 1999 (increasing revenue requirement by about $19 million). This revised position, increasing overall revenue requirement by $31.7 million, is sponsored by Mr. Grate even though the Company has

[40] Grate direct, pages 57-62.

never previously proposed nor sought Commission approval to recognize this accounting change for intrastate regulatory purposes.[41]

Q. How do you know that Qwest has not previously sought Arizona regulatory approval to adopt SOP 98-1?

A. In the Company's 1999 rate case, I sponsored testimony and a pro forma adjustment on behalf of Staff recommending the adoption of SOP 98-1 in the 1999 test year. Qwest opposed that adjustment. Mr. George Redding, then Director-Regulatory Finance for Qwest Corporation, filed rebuttal and rejoinder testimony opposing Staff's recommendation. In my opinion, it is rather unusual and disingenuous for the Company to oppose Staff's proposed adjustment adopting SOP 98-1 in the 1999 test year and now suggest that SOP 98-1 should be recognized in the 2003 test year as if it had been adopted in 1999. This shift in position is the epitome of a "heads the Company wins, tails ratepayers loss" situation.

Q. Do you have any information which addresses why the Company has not sought ACC approval to capitalize internal-use software?

A. Yes. In the Company's last rate case, Data Request No. UTI 13-21(d) specifically requested Qwest's position regarding whether this change should be reflected in Arizona revenue requirements. The Company's response to this portion of that discovery request is reproduced below:

> The company has not petitioned the Arizona Corporation Commission to adopt the software capitalization accounting. Since the life for the capitalized software is very short, the effect of this accounting on ratemaking is to produce a first year dip in revenue requirements followed by a near term turnaround of revenue requirements and over time, higher revenue requirements. Furthermore, the change from expensing of software to capitalization is not cash affecting, while the ratemaking effect would be cash affecting. Given both the short term revenue requirement profile and the fact that software capitalization is not cash affecting the Company does not intend to petition the Arizona Corporation Commission to adopt this accounting.
>
> [Docket T-01051B-99-0105, Data Request No. UTI 13-21(d)]

[41] The supplemental response to Staff Data Request UTI 7-2S1 also values the revenue requirement impact of this change from its prefiled position on this issue at $31.7 million.

Q. Do you have any comments on the Company's position, as stated in the response to Data Request No. UTI 13-21(d)?

A. Yes. As I stated in my direct testimony in that docket, the Company's "not cash affecting" position was specious.[42] Further, Mr. Grate's direct testimony in the pending proceeding originally embraced the adoption of SOP 98-1 in 2003, but he has now revised his position on the basis that it should have been adopted in 1999.

Q. Is it true that adoption of SOP 98-1 has a temporary effect by producing a first year dip in revenue requirements followed by higher revenue requirements over time?

A. Yes. That is a true statement. However, the capital to expense shift resulting from the adoption of FCC Part 32 (FCC uniform system of accounts) a number of years ago resulted in higher initial revenue requirements followed by theoretically lower revenue requirements over time. In order for the Company's regulated customers to receive the full benefit of the capital to expense shift resulting from Part 32 accounting, Qwest's intrastate rates needed to continue to be set on the basis of the Company's cost of providing service, presuming the subsequent savings were actually realized. Nevertheless, any change in accounting method has revenue requirement trade offs.

Q. Since you are recommending that internal-use software be capitalized, rather than expensed currently, how will the Company amortize that investment?

A. With limited exceptions, capital assets are either depreciated or amortized to expense over a reasonable period of time. As a result, the capitalized cost of internal-use software will be amortized to operating expense over a multi-year period. In fact, Qwest has been capitalizing and amortizing these costs for financial reporting, FCC reporting and Oregon regulatory purposes for many years.

Q. What period are you using to amortize these capitalized software costs?

[42] As indicated in the response to Data Request No. UTI 20-12(a) in Docket T-1051B-99-0105, the phrase "not cash affecting" simply means that the change in accounting method will not result in any change in the amount or timing of Company's cash payments to fund software development and modification efforts. Further, the response to Data Request No. UTI 20-12(b) in that same docket confirmed that changes otherwise "not cash affecting" become "cash affecting" merely by recognizing those accounting changes for ratemaking purposes.

A. Consistent with the Company's "book" accounting and Adjustment PFA-03, Staff Adjustment C-11 is based on a five (5) year amortization period.

Q. Earlier, you indicated that the Company's last rate case was resolved by negotiated settlement. How do you know that Qwest was not indirectly granted regulatory authority to adopt SOP 98-1 for Arizona intrastate purposes in that proceeding?

A. It is true that the last rate case (Docket No. T-01051B-99-105) was resolved through negotiated settlement. In support of that settlement Staff witness Brosch and Company witness George Redding, then Director-Regulatory Finance for Qwest Corporation, prefiled written testimony discussing the proposed rate increase of $42.9 million. At pages 2 - 3 of his supplemental testimony, Mr. Brosch provided the following discussion of why the $42.9 million rate increase was reasonable and in the public interest:[43]

> Staff's prefiled direct evidence supported a rate increase of $7.2 million, after making many accounting adjustments and significantly reducing the Company's requested rate of return. In contrast, the Company's filing supports a total revenue increase of $201.2 million. Schedule E within the ACC Staff Joint Accounting Exhibit is a one-page reconciliation of the many issues between Qwest and the Staff that make up the approximately $194 million in dispute between Qwest and Staff in this Docket. ... However, at lines 15 through 45, many operating income adjustments are summarized that total $153.6 million in revenue requirement value (see Line 49). Most of the major issues shown in this listing are vigorously disputed by Qwest. Several of the issues in dispute have no guiding precedent in prior ACC rate orders. If Staff were to <u>not</u> prevail on only a few of the larger operating income adjustments, the resulting approved rate increase would be much larger than the $42.9 million in the Settlement Agreement. Additionally, if the Commission were to grant a return on equity only modestly higher than Staff's 11.75 percent recommendation, the resulting rate increase could be much larger than Staff has recommended.
> [Brosch Supplement Testimony, p. 2, Docket No. T-1051B-99-105]

The testimony of Mr. Brosch also contained the following discussion of those operating income issues proposed by Staff that had no guiding precedent in prior ACC rate orders:

> Adjustment C-13 (Line 28 of Schedule E) reflects adoption of the new SOP 98-01 accounting pronouncement for computer software costs, causing certain software costs previously expensed to now be capitalized

[43] A copy of Staff Schedule E, reconciliation from Docket No. T-1051B-99-105, is appended hereto as Attachment SCC-3, for reference purposes.

> on the books. This adjustment is contested by Qwest and has the effect of reducing test period revenue requirements by $32.8 million in Staff's filing. ... While Staff believes its position is fully supported in prefiled evidence for each of these adjustments, it is entirely possible that litigation of these issues and other Staff adjustments may result in much higher revenue increases in the final rate order than have been agreed upon through settlement.
> [Brosch Supplement Testimony, p. 3, Docket No. T-1051B-99-105]

The rebuttal testimony of Company witness Redding in the last rate case was also illuminating in its description of the negotiation and settlement process, including the following excerpts:

> The settlement process was highly contentious and hard fought. The result reflects the parties' view of the strength of the arguments and voluminous testimony and evidence presented in this case, including direct, rebuttal, surrebuttal and rejoinder testimony by over a dozen witnesses representing several different parties. That testimony was developed in the light of multiple rounds of discovery that yielded answers to hundreds of questions. Both parties carefully considered the Commission's position on issues in Qwest's last rate case. The process of reaching a compromise on the many contested positions in this case was carefully considered and far from arbitrary.
> [Redding Rebuttal Testimony, p. 6, Docket No. T-1051B-99-105]
>
> ...
>
> Although many proposed adjustments were not specifically discussed, Qwest, in reaching a compromise with Staff, was fully cognizant of the fact that if this case were to continue to be litigated, the Commission would be presented with arguments and supporting evidence for each and every position taken by each and every witness sponsored by every party in this case, not just Staff's. It follows that the compromise Qwest reached reflects its assessment of all of the positions and supporting evidence of all of the parties, not just Staff's.
> [Redding Rebuttal Testimony, p. 8, Docket No. T-1051B-99-105]

Although these excerpts clearly illustrate why negotiated settlement agreements typically contain language regarding their non-precedential nature, these passages also clearly establish that major issues raised by Staff, such as SOP 98-1, were vigorously disputed by Qwest and should be considered to have no guiding precedent in future rate proceedings.

Q. If the Company has adopted SOP 98-1 for financial reporting and FCC accounting, has Qwest maintained special accounting records designed to maintain its Arizona regulatory accounting records as if SOP 98-1 has <u>not</u> been adopted?

A. Yes. As detailed in Attachment B to Staff Data Request UTI 1-3, Qwest maintains "offbook" accounting entries to separately track each significant difference between State and FCC regulatory requirements and generally accepted accounting principles ("GAAP"). The following excerpt describes how Qwest keeps track of the differences in accounting for SOP 98-1:

> **BAC 0360 J Software Capitalization – JD**
> Description: In January, 1999, U S WEST implemented the provisions of SOP 98-1, Accounting for Internal Use Software. The SOP dictates that costs for software purchased or developed for internal use be capitalized. Not all State regulatory commissions ordered implementation of the SOP effective 1/1/99. The purposes of this BAC is to reverse the intrastate effects of the capitalization entry for the period of time between 1/1/99 and the effective date of the individual state orders. The balances on this BAC will be amortized over the life of the software and retired at the end of the amortization period.
> [Qwest response to Staff Data Request UTI 1-3, Attachment B]

The facts are clear. Qwest opposed Staff's proposed adjustment to adopt SOP 98-1 in the Company's last rate case, which had a 1999 test year. Qwest adopted SOP 98-1 for both public financial and FCC reporting purposes. Qwest has stated that, among its State jurisdictions, only Oregon adopted SOP 98-1 in 1999. And, finally, Qwest established specific offbook accounting records to ensure that SOP 98-1 was not reflected in its Arizona intrastate operating results.

Referring to the response to Staff Data Request UTI 16-17, Qwest also maintained offbook records for SOP 98-1 in the follow State jurisdictions in 2003: Colorado, Iowa, Idaho, Minnesota, Montana, Nebraska, New Mexico, North Dakota, South Dakota, Utah, Washington and Wyoming. This same response indicated that the reason Qwest maintained offbook records for SOP 98-1 in all the jurisdictions was the same as Arizona: "There have been no orders in any of these jurisdictions implementing SOP 98-1." On balance, Staff believes that the evidence demonstrates that SOP 98-1 has not previously been recognized in Arizona, but should be reflected in the 2003 test and recognized in quantifying overall revenue requirement in this proceeding.

## FAS106 OPEB COSTS

Q. Please describe Staff Adjustments B-8 and C-18.

A. Staff Adjustment C-18 modifies Qwest Adjustment PFA-02 and recognizes other postretirement benefits costs (OPEB costs) on an accrual basis. The primary difference between Company and Staff on this issue concerns the amortization period and amount of the transition obligation, or liability, to be amortized.

Staff Adjustment B-8 revises the Company's proposed rate base offset to reflect internal funding of OPEB accrual basis costs in excess of PAYGO, based on Staff's position that it was the regulatory intent of the parties to adopt accrual basis accounting in Qwest's last rate case.

Q. Please describe Company's proposed adjustment related to its test year accounting for OPEB costs.

A. As discussed by Company witness Grate, Qwest has proposed to adjust test year rate base and operating expense relating to its accounting for FAS106 OPEB costs.[44] Qwest's revised Adjustment PFA-02 increases test year OPEB expense by about $60.5 million and decreases rate base by $117.5 million, to recognize a "change in accounting method." The primary focus of Mr. Grate's direct testimony, at pages 54-56, is the history of OPEB accounting and regulatory treatment in Arizona.

Q. Why has the Company proposed a rate base reduction as part of this change in accounting method?

A. Qwest has proposed the rate base offset in order to recognize internal, rather than external, funding of the amounts recovered from ratepayers in excess of pay-as-you-go (PAYGO) or cash basis accounting.[45] Upon initial adoption of FAS106, some

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[44] See Grate direct testimony, pages 54-56.
[45] Qwest response to Data Request RUCO 3-10.

jurisdictions have required external funding so as to ensure that the funds would be available when needed to pay retiree benefits. Given the complexity of Qwest's attempts to track regulatory accounting and fund assets among and between its fourteen State jurisdictions and the FCC, Staff does not oppose the internal funding approach. However, Staff would require the Company to maintain detailed information supporting the amounts recognized for Arizona regulatory purposes in excess of PAYGO to ensure ratepayers are not denied full credit in future proceedings.

Q. Please provide a brief overview of FAS106.

A. In December 1990, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard No. 106 ("FAS106"), Employers' Accounting for Postretirement Benefits Other Than Pensions, also known as "OPEBs" or "PBOPs". These benefits generally include health care and life insurance benefits provided outside a pension plan to retirees and their spouses, dependents and beneficiaries.

In general, FAS106 requires employers to accrue the cost of OPEBs to expense during the employees' service period, thereby recognizing a balance sheet liability for such obligations for financial reporting purposes. Since pay-as-you-go ("PAYGO") or cash basis was the predominant method of accounting for financial and regulatory accounting for OPEBs prior to the issuance of FAS106, a major component of the incremental cost of moving from the cash to accrual basis of accounting for OPEBs is the transition obligation.

Q. What is the "transition obligation"?

A. Generally, the transition benefit obligation ("TBO") represents the excess of the actuarial present value of the cumulative benefits attributed to employee service over the fair value of any plan assets, as of the date of plan adoption. In other words, the TBO is the unrecognized liability to both active and retired employees attributable to services rendered prior to the date of accrual accounting adoption. FAS106 provides two alternative methods for recognizing this previously unrecognized TBO upon adoption:

- The immediate recognition of the cumulative effect of the change as a current period charge; or
- The straight line amortization of the unrecognized obligation over the average remaining life of employees, or twenty years if longer.

For financial reporting purposes, the Company chose the immediate recognition option. However, for Arizona regulatory purposes, the Company proposed to amortize the TBO over a 17.3 year period in ACC Docket Nos. E-1051-93-183 and T-1051B-99-105.

Q. Have you previously submitted testimony before this Commission addressing the issue of OPEB cost recovery?

A. Yes. I have testified on behalf of Staff in multiple dockets on this matter opposing the adoption of FAS106 for ratemaking purposes, including Docket No. E-1051-88-146 (U S West complaint), Docket Nos. E-1551-89-102 and 103 (Southwest Gas Corporation) as well as Docket No. E-1051-93-183 (U S West rate case).

As indicated in the following excerpt from Decision No. 58927 (Docket No E-1051-93-183), the Commission essentially adopted the recommendations of Staff and RUCO and denied the Company's proposed adjustment to transition from PAYGO to accrual accounting:

> ...we are still not convinced that a change from the cash method to an accrual method which includes past and current costs is appropriate at this time. We are making this decision based upon an overall comparison of the Paygo method versus an accrual method which includes the Transition Costs. We share some of the Company's concerns regarding intergenerational inequities. Ideally, each generation of customers will pay the OPEB costs that directly benefit them and not pay those costs which directly benefit other generations of customers. The existence of the Transition Costs demonstrates that the paygo method does not meet the ideal situation of matching costs and benefits. A change to the accrual method without consideration of the Transition Costs could provide a better match of costs and benefits. Even though the Company for financial purposes has written off the Transition Costs, the Company made it clear it preferred the Paygo method over a straight accrual method without Transition Costs. Based on all the above, we will not recognize for ratemaking purposes the effect of the accounting change proposed by the Company for post-retirement benefits.

> ...
>
> The Company's real concern is whether, when and if it is placed in a completely competitive, unregulated environment, it still will be able to recover all of its OPEB costs and still be competitive. In our mind, such a concern is not all bad since it forces the Company to closely monitor its OPEB costs. Accordingly, we will not adopt the Company's $28 million adjustment.
> [Decision No. 58927, pages 44-45 (Docket No E-1051-93-183)]

Q. Did you file testimony in the Company's last rate case, Docket No. T-1051B-99-105, on this issue?

A. No. Prior to the last rate case, Staff and the Commission had revised their consideration of this issue and proposed or adopted accrual accounting in other proceedings. In the last rate case, Company witness George Redding filed testimony proposing the adoption of FAS106 accrual accounting in testimony similar to that filed by Mr. Grate in the current proceeding. Recognizing that Staff and the Commission had revised their views on this accrual issue prior to the last Company rate case, my testimony was intentionally silent on Mr. Redding's OPEB recommendation. Because Staff's revenue requirement started with Qwest's proposed levels of rate base and operating income, Staff's decision to not oppose the Company's FAS106 adjustment in that rate proceeding had the effect of including the Company's higher accrual accounting costs in Staff's proposed revenue requirement.

Q. Could you briefly summarize the proceedings you referenced as signaling Arizona's revised view on the FAS106 accrual accounting issue?

A. Yes. At page 56 and in footnote 42 of his direct testimony, Mr. Grate states that the Commission previously approved accrual accounting for OPEB costs for ratemaking purposes for Paradise Water Company (Decision No. 60220) and Southwest Gas Corporation (Decision No. 60352).

The following excerpts appear in the Commission's Opinion and Order in Docket No. U-1303-96-283, involving the rate increase application of Paradise Water Company:

> Both RUCO and Staff opposed the Company's request to switch to the accrual method for PBOPs. Each cited previous decisions in

> which the Commission has denied recovery of the FAS No. 106 costs. Staff and RUCO were still concerned with problems such as retroactive ratemaking, intergenerational inequities, and the fact that the liability for future obligations to make PBOPs payments is not known and measurable. In addition, RUCO indicated that FAS No. 106 accruals include expenses based on a series of assumptions that can be expected to change. Further, there is no directive that requires the Company to fund its accrual.
> At the hearing, the Company agreed to use the cash method for PBOPs for this proceeding. However, the Company urged the Commission to adopt the accrual method for future cases…
> We concur with the parties that continuation of the cash method for PBOPs is proper for this case…However, for the reasons set forth by the Company, we find that in future cases the accrual method should be utilized by the Company. We want to make it clear that our determination is solely for this Company and other determinations will be made on a case by case basis.
> [Paradise Water Company, Decision No. 60220, pages 9-10]

Unlike the Paradise Water Company rate case, the Southwest Gas Corporation rate case was resolved by negotiated settlement. Decision No. 60352 approved the Settlement Agreement, which included the following language concerning FAS106 accrual accounting:[46]

> POST-RETIREMENT BENEFITS
> The accounting and ratemaking treatment proposed by RUCO for Post-Retirement Benefits, which is set forth on pages 59 through 62 of the pre-filed testimony of RUCO witness Marylee Diaz Cortez, is adopted.
> [Southwest Gas Corporation, Decision No. 60352, pages 5-6]

Both of these decisions were issued by the Commission in mid-1997,[47] well before Staff and Qwest filed notice of the Settlement Agreement in the Company's last rate case (Docket No. T-1051B-99-105) on October 20, 2000.

Q. Is Staff opposing Qwest's recommendation that accrual accounting be adopted for ratemaking purposes?

46 Southwest Gas Corporation (Decision No. 60352, pages 5-6) issued August 27, 1997.
47 Paradise Water Company (Decision No. 60220) issued May 27, 1997, and Southwest Gas Corporation (Decision No. 60352) issued August 27, 1997.

A. No. Staff is not opposing the concept of accrual accounting for OPEB costs. Instead, Staff contends that Company Adjustment PFA-02 overstates revenue requirement because it fails to recognize the regulatory intent of the parties in the Company's last case to explicitly consider the cost of transitioning to accrual accounting in revenue requirement, even though the settlement agreement in that docket was silent on the issue. Basically, Company Adjustment PFA-02 was quantified as if the amount of OPEB costs recognized in the last rate case was based on PAYGO accounting and results in an overstatement of the transition costs subject to amortization over a dramatically reduced amortization period.

Q. Does the Company discuss how this issue was handled in the last rate case?

A. Yes. In direct testimony, Mr. Grate recognizes that Mr. Redding did propose adoption of FAS106 accrual accounting in the last rate case. However, Mr. Grate also observes that neither the settlement agreement nor the Commission's order in that case (Decision No. 63487) adopted or mentioned OPEB accounting under FAS106. While Mr. Grate accurately points out that Staff and RUCO opposed accrual accounting in Docket No. E-1051-93-183, he fails to mention that neither party opposed Mr. Redding's recommendation in the last rate case. According to Mr. Grate, Qwest has continued to accounting for OPEBs using the PAYGO method for Arizona regulatory purposes.[48]

Q. Do you concur with Mr. Grate's characterization of the treatment of this issue in the last Arizona rate case proceeding?

A. Only in part. Mr. Grate is quite correct that both the settlement agreement and the Commission's order are silent concerning the transition from PAYGO to OPEB accrual accounting. Unfortunately, this observation ignores the fact that the proposed revenue requirements of both Staff and Qwest included $27.4 million for the OPEB transition in excess of PAYGO costs. In spite of the regulatory intent of Staff's acquiescense to the Company's proposed adjustment, Qwest would now pretend as if the Arizona regulatory process has consistently denied the Company any opportunity to recover the higher accrual-basis costs.

48 Grate direct testimony, pages 55-56.

Q. Could you identify the components of the Company's proposed OPEB costs and explain the amounts at issue?

A. Yes. The primary components of the Company's pro forma OPEB costs underlying Adjustment PFA-02 are summarized below and compared to Staff's proposed treatment:

| CONFIDENTIAL | Arizona Intrastate | |
|---|---|---|
| | Qwest Pro Forma | Staff Pro Forma |
| Service Cost | [redacted] | [redacted] |
| Interest Cost | | |
| Expected Return | | |
| Amort. Of Prior Service Cost | | |
| Amort. Of Actuarial Gain | | |
| Subtotal Medical & Life | | |
| APBO/TBO | [redacted] | [redacted] |
| Amortization Period | | |
| Subtotal TBO Amortization[49] | | |
| Pro Forma OPEB Costs (a) | [redacted] | [redacted] |
| | (b) | (c) |

Note (a): Amounts before allocation between expense & capital accounts.
Note (b): Qwest workpapers supporting Adjustment PFA-02.
Note (c): Qwest confidential response to Staff Data Request UTI 47-11, Docket T-1051B-99-105.

Q. Referring to this table, please define the reference to both the "APBO" and "TBO", explaining why the amounts proposed by Qwest and Staff are significantly different.

A. As indicated previously, the TBO (or transition benefit obligation) basically represents the present value of the liability for OPEBs (medical and life insurance benefits) earned by active and retired employees over the fair value of any plan assets, as of the date of plan adoption. Due to the change from PAYGO (cash basis) accounting to FAS106 accrual accounting, the TBO is amortized over a finite period of time (e.g., 17.3 years) in order to transition between these accounting methodologies.[50]

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49 Had Qwest used the 17.3 year amortization period in quantifying Adjustment PFA-02, the [redacted] TBO amortization would have been [redacted]. Similarly, a 10-year amortization of the TBO from the 1999 rate case would increase Staff's proposed [redacted].

50 Confidential Attachment A to the response to Staff Data Request UTI 16-2 (March 31, 1993 Accounting Standards Ruling 92-02, Accounting for adoption of SFAS No. 106) describes the TBO as follows (page 1): "[redacted]

According to FAS106, the APBO (or accumulated postretirement benefit obligation) is the present value of the cumulative benefits earned by employees at a specified date. As of the date of FAS106 adoption, the TBO and the APBO would be the same, except the TBO would be shown net of any related plan assets.

In general terms, the valuation of the APBO will change over time due to assumption revisions (e.g., discount rates, inflation rates, survivor and mortality statistics, etc.) and the mere passage of time, as the APBO is a present value of future obligations. Consequently, establishing the TBO (or APBO) in 1999 for purposes of determining the annual transition amortization will be different than a more current APBO level – such as year-end 2003. Because Staff considers that it was the intent of the parties to adopt FAS106 for Arizona regulatory purposes in the last rate case (i.e., the 1999 test year), the APBO/TBO balance subject to amortization is based on the amount proposed by Qwest in that case and adopted by Staff.

Q. Could you provide more information to explain why the APBO Qwest now proposes to amortize over a ten-year period is larger than the APBO Staff proposes to amortize over 17.3 years?

A. The APBO changes from year to year for several reasons. First, the APBO is a discounted value that should be expected to increase each year, all else remaining constant. Merely due to the passage of time, the present value of a future obligation will change each year, even if the future obligation remains constant in nominal dollars and the discount rate is unchanged. Second, the future obligation and the discounted APBO will increase each year, as participants earn additional benefits that will be payable in future years. Third, the future obligation and the discounted APBO will decrease, or be reduced each year, as retiree obligations are satisfied as the Company incurs costs to provision benefits to participants each year. Fourth, changes in assumptions (e.g., discount rate used to quantify net present value, medical cost inflation trend rate, medical

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[redacted]."

claim cost payout rate, etc.) used to project the future obligation will result in increases or decreases to the aggregate value of the future obligation and the APBO, in relation to the assumptions embedded in earlier calculations of the obligation.[51] In the aggregate, the assumption changes and passage of time since the last rate case has resulted in a higher APBO in 2003 than in 1999.

Q. Also referring to this same table, could you explain the difference between the Company's 10-year versus Staff's 17.3-year amortization period?

A. In response to Staff Data Request UTI 3-3(c), the Company provided the following explanation of the reduction of the TBO amortization period to ten years:

> At the time the Company adopted SFAS 106 in 1992 the TBO amortization period was 17.3 years because the estimated average remaining service lives of its employees in 1992 was 17.3 years. Eleven years later, in 2003, the average remaining service life of employees stands at just slightly over 10 years. According, the TBO amortization period for adoption of SFAS 106 in 2003, instead of 1992, is 10 years.

In the Company's last Arizona rate case, the Company proposed an amortization period of 17.3 years, which was adopted by Staff.

Q. Why, then, should the Commission use the lower APBO/TBO balance and an amortization period of 17.3 years as proposed by Staff?

A. In Qwest's last Arizona rate case (Docket No. T-1051B-99-105), Company witness George Redding sponsored Adjustment P-05 to recognize accrual accounting under FAS106 for intrastate ratemaking purposes. The documentation supporting that adjustment, accepted and uncontested by Staff and RUCO, clearly shows the APBO/TBO amortization being based on a 17.3 year period. Having mutually adopted an APBO/TBO balance and an amortization period, those components should be fixed for intrastate regulatory purposes – as recognized in Staff Adjustment C-18.

Q. Earlier, you indicated that the Company's last rate case was a negotiated settlement and that the subject of OPEBs was not specifically addressed in the settlement agreement.

[51] Qwest response to Staff Data Request UTI 3-3.

Could you elaborate on your position as to why FAS106 should be considered as having been adopted in Docket No. T-1051B-99-105?

A. As discussed at some length in the section of my testimony on the SOP 98-1 issue, Qwest's last rate case (Docket No. T-01051B-99-105) was resolved by negotiated settlement. In support thereof, both Staff witness Brosch and Company witness Redding, then Director-Regulatory Finance for Qwest Corporation, prefiled written testimony discussing the proposed rate increase of $42.9 million. At the risk of being redundant, the following excerpt from pages 2 and 3 of Mr. Brosch's supplemental testimony in that proceeding contains the following discussion of the $42.9 million negotiated rate increase:[52]

> Schedule E within the ACC Staff Joint Accounting Exhibit is a one-page reconciliation of the many issues between Qwest and the Staff that make up the approximately $194 million in dispute between Qwest and Staff in this Docket. ... Most of the major issues shown in this listing are vigorously disputed by Qwest. Several of the issues in dispute have no guiding precedent in prior ACC rate orders.
> [Brosch Supplement Testimony, p. 2, Docket No. T-1051B-99-105]

Company witness Redding also filed rebuttal testimony supporting the settlement, including the following excerpts:

> Although many proposed adjustments were not specifically discussed, Qwest, in reaching a compromise with Staff, was fully cognizant of the fact that if this case were to continue to be litigated, the Commission would be presented with arguments and supporting evidence for each and every position taken by each and every witness sponsored by every party in this case, not just Staff's. It follows that the compromise Qwest reached reflects its assessment of all of the positions and supporting evidence of all of the parties, not just Staff's.
> [Redding Rebuttal Testimony, p. 8, Docket No. T-1051B-99-105]

While negotiated settlement agreements typically contain language regarding their non-precedential nature, the settlement testimony sponsored by Messrs. Brosch and Redding highlight litigation risk and describe the negotiation process. Clearly absent from this testimony is any discussion about reversion to PAYGO accounting or expressed concern that the Commission, in a litigation scenario, would not follow the path of adopting

[52] A copy of Staff Schedule E, reconciliation from Docket No. T-1051B-99-105, is appended hereto as Attachment SCC-3, for reference purposes. FAS106 OPEB does not appear as a contested issue.

FAS106 established in the 1997 rate cases involving Paradise Water Company and Southwest Gas Corporation.

Further, the overall context of the settlement in Qwest's 1999 rate case should be considered. Specifically, the focus of the settlement discussions was not limited to resolving typical rate case issues disputed by the parties. Rather, the extensive negotiations and settlement language signified the departure from traditional regulation and implemented a new regulatory framework that is under evaluation in the instant docket. As a consequence, I do not find it disturbing, dispositve or surprising that OPEB accounting (i.e., PAYGO continuation or adoption of FAS106) was not explicitly addressed in the last rate case settlement agreement, unlike the specific reference contained in the 1997 Southwest Gas Corporation settlement.

Q. Mr. Carver, are you proposing that this Commission go behind a negotiated settlement in order to resolve this issue?

A. No. I am proposing that the Commission consider all relevant information reasonably available from the last proceeding in order to assess whether Qwest Adjustment PFA-02 accurately quantifies the pro forma effect of recognizing accrual basis OPEB expense for ratemaking purposes or materially overstates overall revenue requirement. If the Commission concurs that the information available regarding the regulatory intent of the parties does not support the Company's contention that it has never recovered any accrual basis OPEB costs from Arizona ratepayers, Qwest Adjustment PFA-02 should be modified as proposed by Staff.

It should be noted that, in the 1999 rate case, only AT&T's witness opposed Mr. Redding's OPEB adjustment, as neither RUCO nor Staff opposed Qwest's proposed adoption of accrual accounting for OPEB costs. While AT&T would have certainly been allowed to present its recommendation to the Commission absent the settlement agreement, any presumption that PAYGO accounting was continued in the last case would need to conclude that the Commission was likely to adopt AT&T's recommendation and reject the regulatory policy transition to accrual accounting that commenced in 1997. Based on the information readily available, it is my opinion that the regulatory intent underlying the 1999 settlement agreement was to reflect accrual accounting for OPEB costs as presented by Company witness Redding.

**Other Considerations**

Q. Has the Company's historical accounting for OPEB costs been influenced by how and whether accrual accounting has been adopted by individual regulatory jurisdictions?

A. Yes. Since the early 1990's, the Company has employed a regulatory recovery, or recognition, "test" in its accounting for other postretirement benefits (OPEBs), as evidenced by the following confidential excerpt from the Company's March 31, 1993, Accounting Standards Ruling 92-02, Accounting for adoption of SFAS No. 106:[53]

> **History**
>
> [redacted]
>
> [redacted]
>
> [redacted]
>
> [Staff Data Request UTI 16-2, Confidential Attachment A, page 2]
>
> ...

[53] Staff Data Request UTI 16-2, Confidential Attachment A, pages 2 & 4.

[redacted]

[Staff Data Request UTI 16-2, Confidential Attachment A, page 4]

As indicated in response to Staff Data Request UTI 2-28, Qwest has continued to keep detailed records comparing its jurisdictional accounting for OPEB costs with the timing and method of regulatory adoption of FAS106. Since the early 1990's, the Company has maintained an "OPEB Allocation Model" ("OPEB Model") to track the timing and method of regulatory adoption of FAS106 for purposes of apportioning OPEB fund contributions and earnings on plan assets to the benefit of those jurisdictions that have adopted FAS106 and required contributions to an external fund.

This detailed OPEB Model contains links to [redacted] that are periodically updated by the Company. This detailed tracking of jurisdictional regulatory treatment and allocation of plan assets/ earnings is in stark contrast to the Company's position regarding the FAS87 Pension Asset. As will be discussed in a subsequent testimony section, Qwest argues that the pension asset should be included in rate base, in part because tracking of the regulatory treatment of pension credits is improper and constitutes retroactive ratemaking.[54]

In the context of pension credits and pension asset accounting, Mr. Grate's direct testimony (page 119) generally addresses the subject of cost recovery and ratemaking principles, including the following excerpt:

> Under the same principles that deem accrued depreciation expense to be recovered by shareholders whether or not it actually was, accrued pension expense debits are deemed to be borne by ratepayers and received by shareholders and accrued pension expense credits are deemed to deemed [sic] to be borne by shareholders and received by ratepayers.[55]

[54] As discussed more fully in the pension asset testimony section, Staff disputes the Company's position.
[55] Grate direct testimony, page 119.

Interestingly, Qwest does not follow this recovered as recorded theory when it comes to OPEB costs. Instead, the Company has developed an elaborate jurisdictional tracking model to measure regulatory adoption of FAS106 for purposes of apportioning OPEB contributions and earnings on plan assets to only those jurisdictions that have explicitly authorized and adopted FAS106 and required external funding.

This tracking approach has resulted in an allocation of "zero" plan assets or earnings to Arizona – a sign that at least a portion of the foundation underlying the Company's regulatory approach is comprised of shifting sand that is molded to fit individual circumstances.

Q. How does Qwest account for OPEB costs in its Arizona intrastate regulatory accounting records?

A. This question has been a matter of some confusion. As indicated in the SOP 98-1 section of my direct testimony, Qwest generally maintains its accounting records using methods that may treat certain transactions differently for financial reporting, FCC reporting and State regulatory reporting purposes. The Company's regulatory financial results are initially prepared on a basis consistent with FCC accounting requirements (i.e., an "MR" basis). Differences in accounting treatments or requirements between the FCC and individual State regulatory agencies are typically tracked in the Company's "offbook" or side records (i.e., a "JD" basis), enabling the Company to present operating results consistent with State "jurisdictional" accounting. While not necessarily a complicated concept in and of itself, Qwest's responses to several Staff discovery requests have identified what may be inconsistencies in the Arizona jurisdictional accounting for OPEB costs.

Recognizing that FCC (MR basis) accounting for OPEB costs began to diverge from PAYGO accounting in 1989 and that the Company developed an elaborate OPEB Model to track jurisdictional adoption of FAS106, Qwest's responses to several Staff data requests[56] indicate that the Company has continued to follow accrual methods, not

[56] Qwest responses to Staff Data Requests UTI 3-1, UTI 3-14, UTI 18-7, and UTI 18-8.

PAYGO, for the Arizona intrastate regulatory accounting of OPEB costs – contrary to Mr. Grate's assertion that Arizona has not deviated from PAYGO accounting.

Q. Please summarize those Qwest discovery responses.

A. The following outline briefly summarizes those responses to Staff data requests:[57]

- UTI 3-1(b): Qwest identified two offbook jurisdictional accounting differences between MR and JD accounting. For Arizona intrastate accounting purposes, the Company reverses the 17.3-year TBO amortization recognized for MR basis accounting. The Company also removes the amortization effect of OPEB costs capitalized prior to 1992 associated with the FCC's early adoption of FAS106 current service costs, but not recognized by Arizona. This response does not indicate that Qwest fully reverses all other accrual accounting entries and recognizes PAYGO costs for Arizona intrastate regulatory reporting.
- UTI 3-14(a) & (c): In describing the unadjusted test year expense allocated to intrastate operations, Qwest stated that all OPEB expense included in its unadjusted test year expense is on an accrual accounting basis – not a PAYGO basis.
- UTI 18-7(a): Referring to the response to UTI 3-14 and Qwest's rate filing, the Company is asked to clarify and explain whether the Arizona intrastate test year starting point on Company Schedule C-1 includes OPEB costs on a PAYGO or accrual accounting basis. The response clearly states: "The Arizona intrastate test year starting point includes OPEB costs on an accrual accounting basis."
- UTI 18-8: Again referring to UTI 3-14, the Company was requested to provide the amount of APBO/TBO amortization expense included in the OPEB accrual basis accounting used for Arizona intrastate regulatory accounting purposes. The response stated: "The Company has not been recording OPEB costs on an accrual basis for Arizona intrastate regulatory purposes. On an Arizona intrastate regulatory basis no TBO (or APBO) amortization has been recorded during the test year."

Based on this information, Qwest has not followed PAYGO accounting for Arizona intrastate regulatory accounting purposes – as would be expected, given the Company's position that Arizona has not adopted accrual basis accounting for OPEB costs. Instead, the Company reversed the APBO/TBO amortization, but largely followed accrual accounting consistent with FAS106. This accounting treatment raises interesting questions in the context of the following testimony section concerning the basis of Qwest's proposed rate base inclusion of the pension asset.

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[57] Attachment SCC-6 contains copies of Qwest's complete responses to Staff Data Requests UTI 3-1, UTI 3-14, UTI 18-7 and UTI 18-8.

Q. Please briefly summarize the key elements underlying Staff's proposed TBO amortization.

A. As discussed previously, the adoption of accrual accounting was not disputed by Staff or RUCO in Qwest's last rate case. It is my belief that it was the regulatory intent of the parties in Qwest's last rate case to explicitly recognize the TBO amortization as an added cost of transitioning from PAYGO to accrual accounting, even though the settlement agreement in that docket was silent on the issue. In addition, Qwest has not maintained its Arizona intrastate regulatory accounting records in strict compliance with the PAYGO accounting method adopted by the Commission in Docket No. E-1051-93-183 (Decision No. 58927). Based on this information and history, Staff has recognized accrual accounting for OPEB costs in developing overall revenue requirement, including the amount of the TBO amortization requested by Qwest and not opposed by Staff in Docket No. T-1051B-99-105.

## FAS87 PENSION ASSET

Q. Is Staff proposing an adjustment to the Company's proposed inclusion of the pension asset in rate base?

A. No.

Q. If Staff is not opposing the Company's proposed treatment of the pension asset, why is Staff presenting testimony on this issue?

A. Since Staff has opposed similar recommendations in prior Qwest rate proceedings, the basis for Staff's non-opposition should be clearly communicated. As discussed previously, I believe the Company has misconstrued and misinterpreted Staff's non-opposition to the regulatory recognition of accrual accounting for OPEB costs in Qwest's last rate proceeding (Docket No. T-1051B-99-105) – a problem Staff desires to avoid in future proceedings concerning either OPEB costs or the pension asset.

Q. Why is Staff not opposing inclusion of the pension asset in rate base?

A. Updated Staff analyses of pension credits presumably recognized in the ratemaking process now indicate that Qwest's Arizona intrastate customers have substantially participated in cumulative pension credits, supporting rate base inclusion .

Q. Have you addressed this issue in past rate proceedings involving Qwest?

A. Yes. The following table identifies the Qwest proceedings in various jurisdictions in which I have sponsored testimony opposing the inclusion of a pension asset in rate base:

| Jurisdiction | Case / Docket | |
|---|---|---|
| Arizona Corporation Commission | E-1051-93-183 | (a) |
| | T-1051B-99-105 | (a) |
| Utah Public Service Commission | 97-049-08 | (a) |
| Washington Utilities and Transportation Commission | UT-930074 | (b) |

Note (a): Rate case proceedings. Note (b): AFOR – sharing proceeding.

Q. In the proceedings identified in this table, did you recommend the complete elimination of the pension asset from rate base?

A. Yes. In those proceedings, my pension asset analyses were similar to those prepared in the current proceeding and resulted in recommendations excluding the pension asset from rate base. Absent a demonstration that ratepayers had materially participated in the cumulative pension credits comprising the pension asset, my analyses fairly consistently questioned whether the alleged benefits were instead enjoyed by investors, not ratepayers.

**Pension Cost Accounting**

Q. Please describe the events or circumstances giving rise to the pension asset.

A. In December 1985, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 87 ("FAS87"), concerning employers' accounting for pension costs. Qwest adopted FAS87 for financial accounting purposes effective January 1, 1987. Prior to FAS87, the amount of pension costs distributed to expense and capital accounts was equal to the level of contributions actually made to the pension fund. After the adoption of FAS87, pension costs expensed/ capitalized and pension contributions began to diverge. Since the adoption of FAS87, Qwest began recording negative pension costs (a pension credit) instead of positive pension costs. The pension asset balance represents the accumulation of those pension "credits".

**Staff Approach**

Q. Could you briefly outline the rate base concept?

A. Rate base is commonly viewed as being comprised of net utility asset investments used and useful in providing service to customers. When investors provide the funds necessary to support these company investments, those amounts are generally included in rate base, allowing investors an opportunity to earn a return on invested capital. Similarly, funds advanced, reimbursed, or otherwise paid for by customers are properly excluded from rate base. The direct testimony of Company witness Grate (page 116) discusses various reasons supporting rate base recognition of the pension asset, including:

- The pension asset is a capital asset.
- Investors have contributed the capital for the pension asset.
- There is no sound reason for denying investors a return on the pension asset.

Q. Does the mere existence of pension credits result in an automatic and substantial decrease to the cost of service benefiting ratepayers?

A. No. Under traditional utility regulation, utility rates are based on a test year cost of service, theoretically designed to balance the various components of the ratemaking equation. Once determined, those rates are generally considered just and reasonable until a moving party presents evidence that the utility is materially under, or over, earning the authorized return in support of revised rates. In general terms, the utility is considered to have recovered all costs recorded between rate cases and achieved a reasonable return on its rate base investment.

However, it is not uncommon for regulators to be presented with issues associated with accounting changes (e.g., transition from pay-as-you-go to FAS106 accrual accounting for OPEB costs, adoption of FCC Part 32 capital to expense shifts), cost deferrals (e.g., storm damage, demand-side management costs), amortization requests (e.g., depreciation reserve deficiency, workforce reduction program costs) or tracking mechanisms (fuel cost trackers) that deviate from this general framework. If the mere recording of a transaction meant that ratepayers symmetrically funded increases and benefited from decreases in expense, there would seem to be no need for the deferral, cost tracker or amortization issues that arise in utility regulation. The fact is that such issues do arise and have existed for many years. Rather than dismissively reject these requests, regulators typically review the facts and circumstances unique to each situation and determine whether the regulatory treatment requested by the utility should be accepted, rejected or modified.

The pension asset is no different. While negative pension credits have been recorded since the late 1980's, the question is whether Arizona ratepayers have adequately participated in the reduced expense to support rate base inclusion of the pension asset. In other words, have negative pension costs been included in the cost of service or somehow separately flowed through to customers "as recorded" each year since the adoption of FAS87? If the ratepayers are not the beneficiaries of those pension credits, then the Company and its investors are the only remaining parties that could have benefited from the cost reductions through higher earnings than would have otherwise been achieved.

While Mr. Grate has alleged that investors have "supplied capital to fund the pension asset," he has provided no factual support for the $97 million pension asset Qwest proposes to include in intrastate rate base, gross of ADIT reserves. Such treatment is appropriate only if it is reasonably demonstrated that a comparable level of cumulative pension credits have been flowed through to the benefit of Qwest's Arizona ratepayers.

Q. Do you believe that ratepayers receive the benefit of pension credits merely as a result of recording the negative pension costs?

A. No. The mere act of recording costs or credits does not conclusively demonstrate "who" may have funded, or benefited from, the pension credits. Since Qwest has sought rate base treatment of the pension asset, Qwest should bear some burden to demonstrate that such inclusion is proper. When rate base inclusion is premised on the "as recorded" concept (i.e., the company recorded credits so ratepayers have benefited), I disagree with reliance only on that premise for determining ratepayer benefit and rate base inclusion. Absent some attempt to assess ratepayer participation in those cumulative pension credits, Qwest's rate base proposal would charge ratepayers with a rate base return on funds they may have never received – unnecessarily benefiting Qwest and its investors.

Q. Are you suggesting that the Commission engage in retroactive ratemaking?

A. No, absolutely not. I do not propose or suggest that Qwest should pay back past excessive profits or recoup past operating losses, as implied by Mr. Grate.[58] Instead, the retrospective review would solely be used to gauge the extent of benefits received by ratepayers or retained by investors in determining the amount of the pension asset balance includable in rate base.

Q. Please explain.

A. Prior to FAS87, the pension costs charged to expense/capital accounts and contributed to the pension fund were equal. Subsequent to FAS87, the Company has recorded negative pension costs and made no further pension fund contributions. In order to establish whether ratepayers have inappropriately benefited to the investors' detriment, neither the act of recording costs nor making contributions necessarily establish the pension cost amount ratepayers have "invested" in or "benefited" from through cost of service.

In assessing whether these pension credits have inured to the benefit of ratepayers to the detriment of investors, Qwest would need to demonstrate that the cumulative pension credits reasonably flowed through to its Arizona intrastate customers equal or exceed the pension asset it proposes to include in rate base. In past Qwest proceedings, I have stated that, based on the results of my analyses, Qwest could not demonstrate substantial ratepayer benefits to support inclusion of the pension asset in rate base. While my prior testimonies were accurate, updated analyses now indicate that Arizona ratepayers have received sufficient pension credit benefits to support rate base inclusion.

Q. At page 117 of his direct testimony, Mr. Grate contends that your approach "was not used for any other element of rate base." How do you respond?

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[58] See Grate direct testimony, page 118, footnote 67.

A. I agree that this approach is generally not used for other elements of rate base. However, that criticism fails to address the key points of concern relative to this issue:

- Have ratepayers benefited from the pension credits?
- If so, by how much?
- Is the cumulative extent of those benefits enjoyed by ratepayers sufficient to include the pension asset in rate base?

The implementation of FAS87 resulted in a significant shift in accounting method from a cash basis to an accrual basis – a shift implemented by the Company for accounting purposes outside the context of a rate proceeding. This shift resulted in Qwest recording negative expenses (i.e., pension credits) for fifteen of the past seventeen years. Because the existence of these pension credits are the sole cause of a pension asset being recorded, I believe that it is responsible and reasonable for regulators to question the extent to which ratepayers, not the Company and its investors, have enjoyed the benefits of those annual pension credits.[59]

In this context, Mr. Grate (direct testimony, p. 119) discusses the subject of cost recovery and general ratemaking principles, including the following excerpt:

> Under widely accepted ratemaking principles, the recorded balances for accumulated deprecation [sic] are included in rate base without imposition of any test to prove that shareholders actually recovered the depreciation expense accruals that created the accumulated depreciation balances. There is no rational basis in regulatory accounting or law for asserting that the pension asset should be subject to a recovery test (especially one that is impossible to satisfy) before it too is included in rate base.[60]

It is rather curious that Mr. Grate would suggest that it is improper and irrational to subject any cost of service item to a "recovery test." Although Staff's recommendations on the regulatory treatment of other postretirement benefits (OPEBs) are more fully addressed in another section of my direct testimony, Qwest's own accounting for this item has used just such a "recovery test" since the early 1990's resulting in the Qwest denying Arizona ratepayers any participation in external OPEB fund assets or earnings on

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59 A benefit-burden test.
60 Grate direct testimony, page 119.

plan assets – because this Commission continued pay-as-you-go ("PAYGO") regulatory accounting for OPEB costs, rather than adopt accrual accounting in the early 1990's.

As indicated in the "Test Year" section of my testimony, all components of the ratemaking equation change over time – revenues, expenses and investment. As each component changes, a utility should have a reasonable opportunity to achieve its authorized return (i.e., not materially over or under earn), so long as the components remain in relative balance or changes to one component are mitigated or offset by changes to the other. I generally agree with Mr. Grate that the prohibition against retroactive ratemaking presumes that recorded costs are assumed to be recovered, regardless of explicit inclusion in cost of service.[61] This presumption holds the utility accountable for incurred costs and prevents a potentially abusive process of collecting past earnings deficiencies from current and future ratepayers.

Since adoption of FAS87, the amount of pension credits recorded by Qwest has varied significantly from year to year.[62] In the absence of rate case activity or some mechanism to flow the volatile annual pension credits through to benefit ratepayers, FAS87 pension accounting may have resulted in large pension credits increasing utility income and investor returns. Contrary to implications otherwise, Staff's evaluation of this issue is <u>not</u> designed, intended nor does it result in a retrospective inquiry of past earnings to impose a surcharge for past under-recoveries or a refund for past over-recoveries. Instead, Staff's approach is designed to evaluate, based on available information, whether it is reasonable to assume that ratepayers have sufficiently enjoyed the benefits of the ever fluctuating pension credits (supporting rate base inclusion of some portion of the pension asset) or whether the resulting earnings benefits have been retained by investors (supporting the rate base exclusion).

[61] Qwest Adjustment PFA-02 (OPEB pro forma) values the APBO and selects an amortization period assuming adoption of accrual accounting in 2003, contrary to this very presumption.

[62] The amount of annual pension costs recorded since 1987 have ranged from a positive [redacted] to a negative (credit) of [redacted].

Q. Since Qwest's adoption of FAS87, how does the amount of pension costs included in cost of service compare to the pension credits recorded by the Company?

A. Although it is not possible to precisely quantify the amount of accumulated net pension recoveries from or benefits provided to ratepayers over the decades predating or following the adoption of FAS87, I have prepared a series of calculations which attempt to estimate the level of pension credit benefits ratepayers might have received since the adoption of FAS87. Relying on Company responses to discovery in Docket Nos. E-1051-93-183[63] and T-1051B-99-105,[64] the following table attempts to show the amount of pension credits that might have been flowed through to ratepayers in each proceeding immediately preceding or following the adoption of FAS87.

**Arizona Intrastate – Net Pension Expense**
(000's)

| ACC Docket | Order Date | | Ratemaking Pension Expense |
|---|---|---|---|
| 84-100 | 1/10/86 | | $12,200 |
| 88-146 | 3/01/89 | (a) | (600) |
| 91-004 | 7/15/91 | (a) | (9,900) |
| 93-183 | 1/03/95 | | (9,000) |
| 99-105 | 4/1/01 | (a) | (13,719) |

**Source:** Qwest response to Staff Data Request UTI 3-10.
**Note (a):** Resolved by negotiated settlement.

Using this information, I have prepared two analyses of the net pension credits that might have been flowed through to ratepayers. Both analyses cover the same time period, starting in 1987 and continuing through 2003. While similar in appearance, Appendices SCC-4 and SCC-5 are different in one material respect – how the amount of pension credits flowed through to ratepayers are determined when a rate proceeding is resolved by negotiated settlement, rather than by a regulatory decision in a litigated proceeding.

Appendix SCC-4 recognizes that three of Qwest's Arizona proceedings since the late 1980's (i.e., Docket Nos. E-1051-88-146, E-1051-91-004 and T-1051B-99-105) were

[63] Company responses to Staff Data Request Nos. 191, 386-388 (Docket No. E-1051-93-183).
[64] Company responses to Data Request Nos. UTI 3-12, UTI 20-5 & RUCO 28-3 (Docket No. T1051B-99-105).

resolved by negotiated settlement. Because of these settlements, Appendix SCC-4 assumes that the positive or negative pension costs included in the preceding litigated rate case would continue to be reflected in rates until the next litigated proceeding. Such an assumption would indicate that ratepayers may have provided Qwest with cumulative positive pension expense of $16.6 million, as compared to the negative $97.3 million of cumulative pension credits Qwest proposes to include in rate base.

In contrast, the analysis set forth in Appendix SCC-5 assumes that it is reasonable to consider all relevant information available to assess regulatory intent and estimate the amount of pension credits underlying negotiated settlements, in order to identify amounts included in rates and flowed through to the benefit of ratepayers. Under this approach, in spite of typical non-precedential language contained in settlement agreements, Appendix SCC-5 indicates that ratepayers may have participated in cumulative negative pension expenses exceeding $100 million, supporting rate base inclusion of the pension asset .

Q. Since these two analyses yield significantly different results, why are you recommending that Qwest be allowed to include the pension asset in rate base?

A. It may not be possible to accurately or precisely quantify the exact amount of cumulative net pension recoveries from or benefits provided to ratepayers, particularly over the decades predating the adoption of FAS87. Admittedly, these two analyses produce dramatically different Arizona-specific estimates of the pension credit benefits ratepayers might have received since the adoption of FAS87, due to the valuation treatment of settled rate proceedings. However, in past Arizona rate cases, both analyses consistently indicated that ratepayers had not yet received substantial cumulative benefits from the pension credits to support rate base inclusion of the pension asset. For the first time, the Arizona analysis depicted on Appendix SCC-5 shows that the situation has changed, at least when test year pension credits involving settled proceedings are considered.

Q. In describing Appendices SCC-4 and SCC-5, you indicated that three of the rate cases were resolved by negotiated settlement. Have you previously filed testimony that you were unable to determine what amount of pension credits may have been flowed through to ratepayers as a result of the settlement process?

A. Yes. I have taken the position that, in assessing the amount of pension credits flowed through to ratepayers, only those orders which specifically address the various components of cost of service be considered. Settlements are typically non-specific, by design, and entail any number of compromises in the interest of reaching an acceptable resolution. By its very nature, a settlement agreement reflects a compromise that can often be valued in various ways, not necessarily reflecting the filed positions of any particular party.

However, on further reflection, the amount of pension credits recognized in the three Arizona proceedings resolved by negotiated settlement appear to have been uncontested, at least by Staff. As such, the amount of pension costs recognized in those proceedings would not have necessarily changed, even if each case been litigated. As a result, Appendix SCC-5 appears to better reflect ratepayer participation in the Arizona pension credits.

Q. Do you believe that all elements of the cost of service included in past rates should be reconciled with current cost levels to determine prospective rate treatment for each item?

A. No. As a matter of ratemaking policy, I do not recommend that the Commission rely solely on or otherwise reconcile past decisions in establishing cost of service for future periods. However, the consideration of past rate orders is indeed relevant in assessing whether investors have some claim to inclusion of the pension asset in rate base. As discussed above, Staff is recommending the inclusion of the pension in rate base.

## VOICE MESSAGING – STATE DEREGULATED SERVICE

Q. What is the purpose of Staff Adjustments B-8 and C-24?

A. In direct testimony, Staff witness Rowell recommends Commission approval of Qwest's pending requests to deregulate both Voice Messaging Services and Intrastate Billing and Collection Services for Arizona intrastate regulatory purposes. Because of Staff's recommendation, Staff Adjustments B-8 and C-24 remove the effects of Voice

Messaging Service from the determination of test year rate base and operating income used in the quantification of overall revenue requirement. These adjustments, which Qwest did not propose, have the affect of increasing overall revenue requirement.

Q. Since Staff is also recommending the Arizona deregulation of Intrastate Billing and Collection Services, do these adjustments also remove this service from rate base and operating income?

A. No. According to the response to Staff Data Request UTI 7-15, Qwest has included intrastate billing and collection in the Arizona test year revenue requirement, but cannot separately identify the expenses and investment attributable to this intrastate service. Absent a reasonable quantification offered by Qwest in rebuttal testimony or as a supplemental response to Staff Data Request UTI 7-15, Staff is unable to remove this service from Arizona revenue requirement.

## FCC DEREGULATED SERVICES IMPUTATION

Q. Please describe Staff Adjustment C-19.

A. In quantifying overall revenue requirement, the Company has included above-the-line (or imputed for intrastate ratemaking purposes) all revenues, expenses and investment associated with the provision of FCC deregulated services (except for Public Pay Phone) in the State of Arizona. Staff Adjustment C-19 imputes additional revenues above-the-line for intrastate regulatory purposes in order to ensure that the earnings deficiency associated with these FCC deregulated services are not fully borne (or cross-subsidized) by the customers subscribing to Qwest's Arizona intrastate regulated products and services.[65]

Q. Has Staff recommended that any of Qwest's FCC deregulated services also be explicitly deregulated in the Arizona intrastate jurisdiction?

A. Yes. Staff witness Rowell is sponsoring testimony that recommends approval of the Company's pending application to deregulate Voice Messaging Service in the intrastate

[65] Staff Adjustment C-19 limits the imputed revenues to 50% of the amount required to recognize full revenue imputation, consistent with the findings of the Commission in Decision No. 58927 (Docket No. E-1051-92-183).

jurisdiction.[66] Separate adjustments (Staff Adjustments B-9 and C20) remove the rate base and operating income effects of Voice Messaging Service from cost of service, consistent with this Staff recommendation.

Q. Please describe the reference to FCC deregulated services.

A. In general, Qwest provides a variety of services in Arizona that fall into one of four "jurisdictional" categories: interstate FCC regulated services; intrastate ACC regulated services; services that have been either deregulated or never regulated by the FCC; and services that have been either deregulated or never regulated by the ACC.

Qwest maintains its Arizona accounting records pursuant to FCC Part 32 (the uniform system of accounts or "USOA") on a "total" State basis. FCC Part 36 governs the jurisdictional separation (i.e., allocation or assignment) of the "total" State amounts between interstate and intrastate operations. However, the Part 36 separations rules require that nonregulated results be determined (for the FCC deregulated services) pursuant to FCC Part 64 rules and be removed before the jurisdictional separation process allocates the remaining costs between the interstate and intrastate spheres of Qwest's Arizona operations. FCC deregulated services are specifically excluded from <u>interstate</u> regulated operating results.

Q. In the aggregate, does the inclusion of the FCC deregulated services above-the-line for intrastate ratemaking purposes have the effect of increasing or decreasing the Company's overall revenue requirement?

A. As set forth on Staff Adjustment C-19, the effect of Qwest's proposed treatment increases rate base by approximately [redacted] and decreases net operating income by about [redacted]. Overall, the Company's proposed above-the-line inclusion of the FCC deregulated services increases revenue requirement by about $13.2 million, based on Staff's proposed capital structure and cost rates. However, Staff Adjustment C-19 only recognizes, or imputes, 50% of this revenue requirement impact.

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66 Although the ACC has not yet deregulated any of the FCC deregulated products, the only pending deregulation application filed by Qwest concerns Voice Messaging Service and Intrastate Billing and Collection (Docket No. T-1051B-98-0575). See Qwest's response to Staff Data Request UTI 1-13.

Q. How does Staff Adjustment C-19 protect Qwest's Arizona intrastate customers from bearing, or cross-subsidizing, the earnings deficiency attributable to the FCC deregulated services?

A. Qwest's R14-2-103 Filing supports a higher revenue requirement due to the imputed revenue deficiency (i.e., above-the-line inclusion of the net operating loss and rate base investment) associated with the FCC deregulated services. Full imputation would recognize the amount of additional revenues required for these FCC deregulated services to generate an above-the-line return on investment, or net operating income, equivalent to the weighted cost of capital proposed by Staff for the Arizona regulated services. However, Staff Adjustment C-19 recognizes that the Commission did not adopt Staff's full revenue imputation proposal in Docket No. E-1051-93-183. While not eliminating the entire revenue deficiency resulting from the Company's proposed above-the-line treatment, Staff Adjustment C-19 mitigates the loss otherwise attributed to the remaining Arizona intrastate customers.

In addition, those FCC deregulated services that are provided pursuant to Commission approved tariff (i.e., Premises Services, E911 and National Directory Assistance) have been excluded from the calculation of the 50% imputation adjustment.

Q. If the Commission's final order adopts a weighted cost of capital different than that proposed by Staff, would it be necessary to recalculate Staff Adjustment C-19 to reflect such change?

A. Yes. If the Commission were to adopt different values for the FCC deregulated services (rate base, revenues, or expenses) than proposed by Staff or a different capital structure or cost rates than recommended by Staff, it would be necessary to recalculate the effect of Staff Adjustment C-19, unless such changes had an immaterial effect on the calculation of imputed revenues.

Q. Are you recommending that the Company not continue to provide these services?

A. No. The purpose underlying the Staff's recommendation is to ensure that the earnings deficiency associated with the Company's provision of FCC deregulated services is not borne by regulated ratepayers. If Qwest desires to provide these various services in such a manner that produces marginal or negative margins, Staff is not seeking to interfere with that management discretion.

**FCC Deregulated Services – Unadjusted Financial Results**

Q. Earlier, you indicated that Qwest's FCC deregulated services produce marginal or negative margins. Since Staff and Company have previously addressed this issue in prior rate cases, did Staff attempt to determine whether Qwest viewed those marginal results to be acceptable?

A. Yes. Staff Data Request UTI 9-9 specifically inquired whether Qwest viewed as acceptable the test year operating results of those FCC deregulated services, which operated at a loss or produced small positive earnings. In its confidential response, Qwest pointed to the 2003 unadjusted loss on its Arizona intrastate regulated operations (citing to Rule R14-2-103 Filing, Schedule A-2 "Summary Results of Operations"), which shows a return on investment of a negative 9.09%. In this context, Qwest replied to the discovery question, as set forth in the following confidential excerpt:

[redacted]

[redacted]

[redacted]

Q. Do you concur with the Company's apparent view that the test year operating results achieved by the FCC deregulated services are superior to and more acceptable than Arizona's regulated intrastate jurisdiction as a whole?

A. No. There are certain deficiencies in the Company's response that should be addressed. First, citing to Schedule A-2 of the Company's R14-2-103 filing, Qwest fails to recognize that the unadjusted intrastate regulated return on investment of a negative 9.09% includes an unadjusted net loss of about [redacted] for the very FCC deregulated services the Company proposes to include above-the-line in quantifying Arizona intrastate revenue requirement. Although the exact amount of the average net investment of the FCC deregulated services also included in the calculation of the negative 9.09% intrastate regulated return is not readily available, Qwest's confidential response to Staff Data Request UTI 1-13 supports an average investment of about [redacted]. Contrary to the Company's assertion that the FCC deregulated services generated a "corrected" [redacted] return on average net investment during 2003, those very same FCC deregulated services contributed a [redacted] on average investment (excluding payphone) that is embedded in the cited 9.09% negative intrastate regulated return on investment.

Second, these returns on average investment are based on net income before interest expense. On a net income basis, the FCC deregulated services generated a return on average investment during 2003 in excess of a [redacted] (excluding payphone).

Third, it should be noted that the need to present "corrected" financial results now attributed to FCC deregulated services (excluding payphone) was the result of Qwest compiling the response to Staff Data Request UTI 9-8.[67] According to that response, the Company's review of the expenses assigned to "Planning for Enhanced Services" ("Planning") determined that "a majority of these amounts should have been assigned to deregulated payphone" product code, not the Planning category. This "correction" had the effect of shifting about $9.9[68] million of expense from Planning to Payphone. Although the "correction" has been quantified by Qwest and accepted by Staff, the recognition of that correction for revenue requirement purposes does not correct the "error" embedded in the unadjusted operating results cited by Qwest.

Finally, the unadjusted returns on average investment cited by the Company fail to conform with the realities of Qwest's recommendations in this proceeding and the pro forma adjustments included in its revenue requirement calculations. For example, overall revenue requirement is based on end-of-period, not average, rate base. Further, Qwest Adjustment PFN-03 is based on a series of regression analyses, resulting in a significant decrease in test year revenues attributable to the very FCC deregulated services that the Company has included above-the-line for Arizona intrastate revenue requirement purposes. In the aggregate, Qwest's adjustments reduce test year revenues for these services by about $14 million, causing a significant deterioration in the otherwise [redacted] ([redacted] "corrected") return on investment Qwest claims to have been generated during the test year.

**Products and Services**

Q. Could you briefly identify the various products and services which are included in the category of FCC deregulated services that Qwest has proposed to recognize above-the-line?

A. Yes. The following table lists the eleven FCC deregulated product categories that Qwest has included above-the-line, indicates whether the services are offered pursuant to tariffs

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67 Staff Data Request UTI 9-8 sought information regarding the specific planning, development, research, marketing and deployment activities undertaken during 2003 that contributed to the operating results associated with the FCC deregulated service category "Planning for Enhanced Services."

68 Qwest non-confidential response to Staff Data Request UTI 9-8 quantifies the effect of reclassifying the Planning charges to Payphone.

approved by the ACC and identifies which "basket" of the Arizona Price Cap Plan the various products are included:

| Product | ACC Tariff?/ Basket | Pricing Flexibility |
|---|---|---|
| 1. Protocol Conversion | No | Unregulated |
| 2. Premises Services | Yes/3 | May increase rates; price changes limited to Basket 3 revenue cap. |
| 3. Customer Dial Account Recording | No | Unregulated |
| 4. Voice Messaging | No/3 | Detariffed since introduced in late 1980's; price changes limited to Basket 3 revenue cap. |
| 5. E911 Nonregulated | Yes/1 | May increase rates; price changes limited to Basket 1 revenue cap. |
| 6. Information Services | No | Unregulated |
| 7. National Directory Assistance | Yes/3 | May increase rates; price changes limited to Basket 3 revenue cap. |
| 8. Joint Marketing | No | Marketing for unregulated Direct TV & Affiliate Billing; not offered to AZ customers. Priced per FCC affiliate transaction rules. |
| 9. Unregulated Wholesale | No | Unregulated |
| 10. Unregulated Alarm | No | Unregulated |
| 11. Planning for Enhanced Services | No | Unregulated |

**Source:** Qwest (non-confidential) response to Staff Data Request UTI 9-16.

Of these eleven services, three (3) are provided pursuant to ACC approved tariffs and four (4) are included in Arizona Price Cap Plan Baskets (one in Basket 1 and three in Basket 3). Only Voice Messaging has been detariffed since its introduction in Arizona, but has been included in Basket 3. Staff is recommending the intrastate deregulation of this service.

Q. Is Qwest losing money on these FCC deregulated services?

A. Based on the response to Staff Data Request UTI 9-9, these eleven (11) FCC deregulated service categories produced [redacted] "corrected" net operating income during the test year.. Attachment SCC-7, page 1, shows the "corrected" test year operating results and end-of-period rate base investment, before recognizing Qwest's pro forma ratemaking adjustments, for these eleven FCC deregulated service categories.[69]

[redacted] were the only FCC deregulated service categories that generated relatively significant [redacted] income during the test year, thereby minimizing the net loss from all other FCC deregulatedsServices. With regard to Voice Messaging, the Company previously filed a petition with the ACC to deregulate this service, which Staff witness Rowell is now recommending be adopted – along with intrastate billing and collection services. Absent the earnings generated by this service, the net operating income summarized on Appendix SCC-7 becomes a net loss, before recognizing Qwest's pro forma ratemaking adjustments.

Q. In quantifying the imputed revenues, does Staff Adjustment C-19 recognize the Company's pro forma ratemaking adjustments that impact these FCC deregulated services?

A. Yes. Staff Adjustment C-19 does incorporate the reduction in FCC deregulated revenues proposed by Qwest via Company Adjustments PFN-01, Out-of-Period, and PFN-03, Revenue Trending as well as the elimination of the NOI and rate base amounts attributable to Voice Messaging.

Q. Over the past several years, has the Company revised the prices charged for its individual FCC deregulated service offerings?

A. Yes. Confidential Attachment SCC-7, page 2, summarizes the price changes for the FCC deregulated services identified by the Company in response to Staff Data Requests UTI

[69] Staff Adjustment C-19 incorporates the additional nonregulated revenue reductions contained in Qwests Adjustments PFN-01, Out-of-Period, and PFN-03, Revenue Trending (regression analyses).

9-6 and UTI 9-7.[70] According to the referenced responses, the pro forma affect of the 2003 price changes are already reflected in the test year, but no quantification of the pro forma impact of price changes in other calendar years was provided, as a special study would be required.

**Above-the-Line vs. Below-the-Line Recognition**

Q. Why has Qwest included the earnings deficiency associated with these FCC deregulated services above-the-line for Arizona intrastate revenue requirement purposes?

A. Generally, Qwest has taken the position that all FCC deregulated services (except Payphone) should be considered as intrastate regulated services and included above-the-line for intrastate regulatory purposes, absent specific ACC decisions or orders deregulating such services.[71] Referring to the earlier table, only three of the eleven FCC deregulated services are provisioned under Commission approved tariffs, with Qwest describing its pricing flexibility in Arizona as "unregulated" for the remaining eight FCC deregulated services. Contrary to any assertions otherwise, Qwest has provided no clear and convincing evidence establishing that all of the FCC deregulated services are properly recognized above-the-line for intrastate revenue requirement purposes, absent imputing additional revenues as proposed by Staff.

Q. Do you believe that the Company's proposed above-the-line recognition of the FCC deregulated services protects intrastate customers from cross-subsidizing those services?

A. No. In my opinion, the inclusion of the FCC deregulated service above-the-line in calculating intrastate revenue requirement does not protect intrastate customers from potential cross-subsidies, as envisioned by the FCC's Part 64 accounting rules. By including the FCC deregulated services above-the-line, the Company has ignored protections addressed in the Part 64 rules, by reflecting the aggregate pro forma losses experienced by these services and related net investments above-the-line without any revenue imputation – contrary to the ACC's order in Qwest's last Arizona rate case (Docket No. E-1051-93-183).

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[70] Qwest considers all pricing information for all FCC deregulated services, other than joint marketing, to be confidential.

[71] Direct testimony of Qwest witness Grate, pp. 130-131.

Q. Why do you believe that revenue imputation is the appropriate response to the Company's request to include the FCC deregulated services above-the-line?

A. There are several reasons why revenue imputation is an appropriate remedy for this issue.

First, Staff's proposed revenue imputation only applies to the seven (7) FCC deregulated services that are not provided pursuant to Qwest tariffs approved by this Commission.[72] Consequently, Qwest has complete discretion over the pricing of the services included in these product categories. If the Company believes that deregulated product revenues are unacceptably insufficient to cover the recorded cost of a service or group of services, the appropriate response would be for the Company to decrease costs and/or increase the price charged – not attempt to attribute any losses to the Company's intrastate customers taking regulated, tariffed services. To the extent that Qwest exercises discretion over the pricing of its FCC deregulated services, it should be shareholders, not ratepayers, who are accountable for any losses from such operations.

Second, Qwest can (and has) increased the prices charged for certain FCC deregulated services subsequent to the test year. In doing so, the pro forma operating loss attributed to the test year has and could further change, resulting in the above-the-line test year losses no longer being representative of ongoing conditions. The combination of post-test year price changes <u>and</u> Commission adoption of Qwest's above-the-line recommendation could result in the double-recovery of a portion of the pro forma losses attributed to Qwest's FCC deregulated services.

Third, Qwest could choose to provision financially promising FCC deregulated services through a separate affiliate, rather than by Qwest Corporation pursuant to Part 64 rules. This could result in all FCC deregulated services that are "losing" money being provisioned by Qwest and theoretically includable above-the-line for Arizona regulatory purposes, while potentially profitable FCC deregulated services could be provisioned by

[72] Of the eleven FCC deregulated services, three are provided pursuant to ACC approved tariffs and one is detarriffed. The remaining seven services are considered in the quantification of Staff Adjustment C-19.

a separate affiliate and insulated from offsetting less successful above-the-line services. Under such a scenario, adoption of the above-the-line recommendation without at least partial revenue imputation could result in the Company's regulated customers providing direct subsidies to the FCC deregulated services, depending on the structure of any revisions to the Arizona Price Cap Plan and whether regulated rates are revised.

Fourth, FCC Part 64 [47 CFR 64.901] requires carriers, such as Qwest, to separate their regulated and nonregulated costs using the attributable method of cost allocation. Part 64, which resulted from FCC orders in CC Docket No. 86-111, established procedures intended to protect interstate regulated operations from cross-subsidizing the nonregulated activities of the telecommunications industry. All nonregulated revenues and costs, consistent with Part 64, are removed from a carrier's operating results prior to the jurisdictional separation of the remaining regulated costs between interstate and intrastate operations. The Company's above-the-line treatment has the effect of shifting 100% of the potential cross-subsidy to those customers subscribing to Qwest's Arizona <u>intrastate</u> regulated services. I do not believe that such a shift in cost responsibility is the appropriate or intended result of the FCC's actions to protect <u>interstate</u> regulated services. Rather than impute additional revenues to offset the entire revenue requirement shortfall for the seven FCC deregulated services, Staff has proposed only a 50% imputation consistent with Commission Decision No. 58927.

Q. Would it be possible to achieve a result comparable to above-the-line imputation by simply moving the FCC deregulated services below-the-line?

A. Yes. Under full revenue imputation, which Staff is not currently recommending, the revenue requirement impact of these two alternatives would be identical. However, I have not proposed an adjustment moving the FCC deregulated services below-the-line out of concern whether Commission adoption of such treatment could be construed by Qwest as the intrastate deregulation of those individual services, even though no detailed investigation of the individual services has been presented or conducted.

**ACC Decision 58927, Docket No. E-1051-93-183**

Q. At pages 128-132 of his direct testimony, Mr. Grate discusses certain adjustments Qwest has not recognized in its R14-2-103 Filing, even though the Commission had addressed these areas in prior Arizona rate case orders. Did Qwest propose any ratemaking adjustments relating to the FCC deregulated services?

A. Yes. Qwest has presented several proposals in this regard:

- Qwest included its FCC deregulated services above-the-line for Arizona intrastate ratemaking purposes;
- Qwest proposed pro forma revenue adjustments that reduced test year FCC deregulated service revenues; and
- Qwest quantified and applied higher composite Arizona intrastate separation factors, recognizing the FCC deregulated services as intrastate services, resulting in a larger portion of each Company accounting, normalizing and pro forma adjustment (requiring jurisdictional separation) being attributed to intrastate operations for revenue requirement purposes.

What Qwest has not done is to recognize any imputed revenues to offset any portion of the pro forma revenue requirement related to the inclusion of these FCC deregulated services above-the-line for intrastate purposes. With regard to the imputation of revenues for FCC deregulated services, Staff Data Request UTI 1-11 identified the absence of such an imputation adjustment in the Company's R14-2-103 filing and sought the calculation of the adjustment that would be required if the Commission's ruling in the Company's 1993 rate case was implemented without re-litigation. Qwest's response observed, in part, that the Commission only approved 50% of Staff's adjustment and declined to provide the requested calculation.

Q. Are you familiar with that portion of ACC Decision 58927 which addresses the issue identified as FCC Deregulated Services?

A. Yes. I sponsored testimony on behalf of the Staff on that issue. In general terms, Qwest has accurately paraphrased the Commission's actions as set forth in Decision No. 58927, Docket No. E-1051-93-183. The Commission discussed the FCC deregulated services issue at pages 21-23 of ACC Decision 58927, including the following excerpts:

> ...Prior to FCC deregulation, these services were subject to the separation process. As a result of deregulation, the FCC has ruled that the services must be excluded from interstate costs and ratemaking. In this case, U S West has proposed to include all of the revenues, expenses and investment associated with its FCC deregulated services above-the-line for intrastate ratemaking purposes. According to the Company, the prices for these services are market based but do not cover their fully distributed costs.
>
> According to Staff, interstate deregulation should not by itself increase expenses to the intrastate jurisdiction. The services in question have expenses of approximately $7 million more than the associated revenues. Hence, the Company's proposal will result in other Arizona customers bearing the burden of the $7 million deficiency....As part of its case, the Company requested a $5,356,330 increase in revenues for inside wire charges. Staff concurred with the Company's proposed increase as part of its overall rate design in the case. Staff then imputed additional revenues of $1,662,000 to offset the remaining deficiency for the FCC deregulated services.
> [ACC Decision 58927, p. 21-22]

Qwest's recommendation in the current proceeding has not changed from its position in its last two rate cases (Docket Nos. E-1051-93-183 and T-1051B-99-105). The Company has once again proposed to include the pro forma net loss and rate base investment associated with the FCC deregulated services above-the-line for intrastate ratemaking purposes. Except for changes in the dollar values contained in the above excerpts, the summary of this issue from that Arizona rate case continues to apply today.

Q. Did ACC Decision 58927 adopt the Staff's revenue imputation proposal?

A. The Commission did adopt the concept of revenue imputation, but not the full amount recommended by the Staff. The following discussion appears at page 22 of Decision 58927:

> ...As to the remaining revenue deficiency for the FCC deregulated services in the amount of $1,662,000 we concur with Staff that interstate deregulation should not by itself increase expenses to the intrastate jurisdiction. On the other hand, we don't find Staff's method of simply imputing revenues to offset the entire deficiency provides an overall just result either. ... In addition, in order to recognize that neither the interstate nor intrastate jurisdictions should bear the entire deficiency of the deregulated services, we will approve 50 percent of the Staff's recommended imputed revenues or $831,000.
> [ACC Decision 58927, p. 22-23]

In the current proceeding, the Company has not contested the Commission's past inclusion of the FCC deregulated services above-the-line, but continues to argue against the imputation of any additional revenues – even though the Commission adopted 50% of the imputation adjustment I sponsored on Staff's behalf. In the current proceeding, Staff Adjustment C-19 conforms to the Commission's 50% treatment.

Q. In light of the differing regulatory treatment of these FCC deregulated services, does the Company use the same cost allocation methodology for both interstate and Arizona intrastate accounting purposes?

A. In response to RUCO Data Request 2-74, Qwest indicated that although the FCC and ACC requirements have somewhat different purposes and apply to different products/services, the regulated/nonregulated cost accounting segregation principles are consistent. Qwest's Arizona intrastate cost accounting procedures closely follow FCC Part 32 (USOA) and Part 64 rules and other cost accounting principles.

Q. Has Staff proposed to limit the revenue imputation adjustment to only 50% of the deficiency, as adopted by the Commission in the last rate case?

A. Yes. Consistent with Decision 58927, I continue to believe that interstate deregulation should not, by itself, increase costs to the intrastate jurisdiction.

**Revenue Imputation**

Q. Please describe the phrase "revenue imputation" as it applies to FCC deregulated services.

A. Qwest has proposed to include the pro forma net operating loss and the related rate base investment for the FCC deregulated services above-the-line for intrastate revenue requirement purposes. In this context, "revenue imputation" refers to the recognition of sufficient additional revenues for intrastate regulatory purposes so that, in the aggregate, the FCC deregulated services will earn the same overall return on investment that the ACC ultimately adopts for Qwest's intrastate regulated services. By imputing additional revenues, the Company's Arizona regulated customers will not be required to subsidize the earnings deficiency experienced by the Company's FCC deregulated services and will be indifferent as to whether these services are included above-the-line or moved below-the-line.

If the Commission were to determine that, for example, Qwest should be allowed to earn a return on investment of 10% (i.e., the weighted cost of capital), full imputation would recognize additional revenues sufficient to result in the FCC deregulated services achieving that same 10% return on investment. Staff's proposed 50% imputation would not result in those services achieving a 10% return on investment.

Q. By proposing a "revenue imputation" adjustment, are you suggesting that Qwest should increase the prices charged for its FCC deregulated services to collect those additional revenues from the customers subscribing to those services?

A. No. I am not suggesting that Qwest should change the method or approach it uses to price its FCC deregulated services. Instead, the imputation of additional revenues suggests that those customers subscribing to Qwest's intrastate regulated services should not be required to subsidize the Company's FCC deregulated offerings.

Q. In ACC Decision 58927, the Commission adopted 50% of the Staff's revenue imputation adjustment. Could you please summarize the revenue requirement effect of the Company's above-the-line proposal in the current proceeding and compare that effect with the issue presented to the Commission in Docket No. E-1051-93-183 as well as the last Arizona rate case, Docket No. T-1051B-99-105?

A. Yes. During the test year in the 1993 rate case, the Company's FCC deregulated services experienced a revenue deficiency of approximately $7 million. Because the Company proposed to increase its inside wire charges by $5.4 million as part of its overall rate design in that case, the Staff proposed to impute additional revenue of $1,662,000 to offset the remaining deficiency for the FCC deregulated services. However, the ACC only adopted 50% of the imputation, or $831,000. [ACC Decision 58927, p. 21-23]

In the last settled rate case (Docket No. T-1051B-99-105), Staff Adjustment No. C-17 imputed additional revenues of approximately $3.5 million – more than twice the value of the imputation adjustment Staff proposed in the 1993 proceeding.

In the current proceeding, Staff Adjustment C-19 proposes to impute additional revenues of about $6.6 million,[73] after recognizing the pro forma affect of other Company sponsored adjustments. In assessing Qwest's overall revenue requirement, I believe that any imputation less than Staff;s proposed revenue adjustment would be a disservice to those Arizona customers subscribing to the Company's intrastate regulated services.

The FCC Cost Allocation Manual ("CAM") resulting from Part 64 emphasizes direct cost assignment and "...allocates common cost to the nonregulated sector but leaves it wholly to the business judgment of the company and to the market place to determine how the company recovers (or fails to recover) those costs." [Report and Order CC Docket No. 86-111 (or R&O 86-111), par. 115] Discretionary pricing flexibility, dependent on market conditions, provides little certainty of the ongoing losses (or profits) of the FCC deregulated services that Qwest has proposed be absorbed by regulated ratepayers.

**Voice Messaging Service**

Q. When did Qwest seek the explicit deregulation of Voice Messaging Service in Arizona?

A. On September 25, 1998, the Company filed a petition with the ACC requesting the deregulation of its voice messaging service (VMS). Qwest has also sought State deregulation of its Arizona Intrastate Billing and Collection service, which is not classified as an FCC deregulated service.

Q. What is the status of Qwest's petition to deregulate VMS?

A. As indicated previously, the direct testimony of Staff witness Rowell is recommending State deregulation of this service.

[73] Represents 50% of the full revenue decificiency for the seven remaining FCC deregulated services.

Q. Is it correct that, in spite of the Company's proposed deregulation of VMS in Arizona, Qwest is recommending above-the-line treatment of VMS for intrastate ratemaking purposes?

A. Yes. The Company's confidential response to Staff Data Request UTI 9-9 indicated that, during the test year, VMS experienced [redacted], representing a [redacted] return on year-end investment, using the "corrected" data supplied by Qwest. Consequently, the Company's proposed inclusion of VMS above-the-line for ratemaking purposes has the effect of [redacted] overall revenue requirement otherwise generated by the remaining FCC deregulated services. The State deregulation of this service, as proposed by Staff, will result in the [redacted] the revenue requirement effect of Qwest's proposed above-the-line treatment.

**Accounting for FCC Deregulated Services**

Q. You previously referred to the FCC's accounting for these deregulated services. Could you briefly explain the background of this accounting?

A. Yes. In a REPORT AND ORDER issued in CC Docket No. 86-111 [released February 6, 1987], the FCC adopted a fully distributed costing method which emphasized direct assignment based on cost causation, required the development of Cost Allocation Manuals by the Bell operating companies, and segregated the costs of nonregulated services from the regulated costs subject to jurisdictional separations. The following excerpt appears in the introduction section of this FCC decision:

> We proposed to develop a system of accounting separation that would inhibit carriers from imposing on ratepayers for regulated interstate services the costs and risks of nonregulated ventures. Our ultimate, statutory goal was to promote just and reasonable rates for services in the interstate jurisdiction. [footnote omitted] We tentatively concluded that, to achieve our purposes, it would be necessary to deter cost shifting both in the form of misallocation of joint and common costs and in the form of improper intracorporate transfer pricing.
> [REPORT AND ORDER CC Docket No. 86-111, par. 1]

In the introduction to the Qwest's Cost Allocation Manual provided in response to Data Request UTI 1-9, the Company recognizes the FCC's concern of "guarding against cross-subsidy of Nonregulated ventures by Regulated services, and that cross-subsidy can result either from the misallocation of common costs or from improper intracorporate transfer pricing."

Q. Could you explain what is meant by a service being "subsidized" by other services?

A. In my opinion, a subsidy or cross-subsidy occurs in situations in which one or more services derive benefits from other services without assuming adequate responsibility for the associated costs. The failure of a service to assume adequate cost responsibility can result in the shifting of any unrecovered costs to other services which, in turn, could inappropriately be required to assume responsibility for providing a subsidy, absent specific regulatory treatment providing otherwise.

Q. Would the above-the-line recognition of the FCC deregulated services, as proposed by the Company, constitute a cross-subsidy of such services by the balance of the Company's Arizona intrastate regulated services?

A. Yes. In my opinion, the imputation of additional revenues as proposed by the Staff will help mitigate cross-subsidy concerns.

## FCC DEREG – SEPARATIONS ADJUSTMENT

Q. Please describe Staff Adjustments B-10 and C-20.

A. Because of the Company's proposal to include the FCC deregulated services above-the-line for ratemaking purposes, Qwest calculated higher composite, intrastate separation factors for use in allocating its accounting, normalizing and pro forma ratemaking adjustments. The higher separation factors have been used by the Company and Staff to compute the intrastate share of the individual adjustments posted to rate base and operating income. Staff Adjustments B-10 and C-20 correct the intrastate separation of those various adjustments to reflect lower separation factors resulting from the exclusion of the FCC deregulated operations from the development of jurisdictional separations.

Q. Why are these adjustments necessary?

A. Because Qwest chose to directly assign 100% of the revenues, expenses and net investment of certain FCC deregulated services to its Arizona intrastate operations, the composite separations factors computed and applied by the Company have the effect of over-allocating individual ratemaking adjustments to intrastate operations. These Staff adjustments correct this over-allocation.

Ultimately, the Commission will decide how to treat the FCC deregulated services for revenue requirement purposes. If the Commission agrees with Staff's revenue imputation approach or simply moves such services below-the-line, Staff Adjustments B-10 and C-20 are necessary to remove the incremental separations affect on all other revenue requirement adjustments.

However, Staff Adjustments B-10 and C-20 assume that the Commission will adopt all adjustments proposed by Company <u>and</u> Staff. Should the Commission reject or revise individual adjustments proposed by Company or Staff, Staff Adjustments B-10 and/or C-20 should be recalculated for consistency with the Commission findings.

Q. Did the Company also revise its separation factors as a result of the "correction" that shifted additional costs from Planning for Enhanced Services to Public Payphones?

A. Yes. Because of the manner Qwest quantified the composite intrastate separation factors applied for Arizona revenue requirement purposes, this "correction" also caused the Company to similarly modify its jurisdictional allocation factors and resulted in an new pro forma adjustment [Qwest Adjustment PFN-14], also included in Staff Adjustments B-1 and C-1. Qwest Adjustment PFN-14 revises the composite intrastate separation factors in a manner similar to Staff Adjustments B-10 and C-20.

## INTEREST SYNCHRONIZATION

Q. Please describe Staff Adjustment C-21.

A. Staff Adjustment C-21 synchronizes the interest deduction for income tax purposes with Staff's weighted cost of debt and rate base recommendations. This method of annualizing interest expense is commonly referred to as interest synchronization.

Q. Please define interest synchronization.

A. Interest synchronization is a method which provides for the allocation of an interest expense deduction for income tax purposes to ratepayers equal to the ratepayers' contribution to the Company for interest expense, regardless of the Company's actual or estimated interest payments to its creditors. Since revenue requirement is partially driven by the application of a rate of return to the rate base investment, the Company will recover from its ratepayers an amount of interest expense equal to the effective weighted cost of debt embedded in that rate of return. Thus, ratemaking interest can be quite different from the actual interest expense which might otherwise be deductible on a company's consolidated or stand-alone corporate tax return. Interest synchronization merely "synchronizes" the ratemaking tax deduction for interest with the interest expense ratepayers are required to provide the Company in utility rates.

Q. Did the Company propose the use of interest synchronization in quantifying its proforma level of income tax expense?

A. Yes. Company witness Grate briefly discusses Qwest's approach to quantifying pro forma income tax expense at page 104 of his direct testimony, specifically referring to Company Adjustment PFR-03 as using this interest synchronization methodology.

Q. If Qwest employed interest synchronization, why is it necessary for the Staff to separately quantify an adjustment for interest synchronization?

A. Had the Staff concurred in the Company's valuation of both rate base and cost of capital, a separate adjustment for interest synchronization would not have been necessary. However, when Staff proposes, or the Commission ultimately orders, a different valuation of rate base or the weighted cost of debt, it is necessary to quantify a separate incremental adjustment to recognize the impact of such changes on the ratemaking deduction for interest expense. In the event that the Commission ultimately adopts rate base and/or capital cost valuations other than those presented by either the Staff or the Company, interest synchronization should be recalculated using the Commission's findings, thereby appropriately synchronizing these revenue requirement elements. Consequently, the amount of pro forma interest expense ultimately recognized for ratemaking purposes should simply "roll out" from the Commission's ultimate decisions on allowable values of jurisdictional rate base and weighted cost of debt.

## INCOME TAXES & REVENUE CONVERSION FACTOR

Q. What is the purpose of this portion of your testimony?

A. During the review of the Company's proposed adjustment to net operating income, Staff determined that Qwest had employed incorrect effective Federal and State income tax rates in quantifying the income tax effect of certain adjustments. In response to Staff Data Request UTI 18-10, Qwest concurred and indicated that the tax effect of each Company adjustment should reflect an effective Federal income tax rate of 32.5612% and an effective State income tax rate of 6.968%. In addition, the Company indicated that the revised effective income tax rates will change its Revenue Multiplier to 1.695858, instead of the factor applied in the Company's June 21, 2004 update filing. In supplemental responses to Staff Data Requests UTI 1-1 and 7-2, Qwest provided revised adjustments and schedules to quantify the revenue requirement impact of these revisions. The Company's adjustment to correct income tax expense has been included in Staff Adjustment C-1.

Q. In quantifying overall revenue requirement, Qwest Schedules A-1 and C-3 support a "gross revenue conversion factor" of 1.6876 in translating the operating income deficiency into the gross revenue requirement proposed by the Company. Do the corrections to the effective Federal and State income tax rates also affect the gross revenue conversion factor?

A. Yes. As indicated in the response to Staff Data Requests UTI 15-18 and 18-10, the Company has revised the calculation of the revenue conversion factor from 1.6876 to 1.6958. The effect of this change is to increase overall revenue requirement.

Q. Referring to Staff Schedules A and A-1, has Staff used the 1.6876 or 1.6958 revenue conversion factor in quantifying overall revenue requirement?

A. In presenting the Company's proposed rate changes, Staff's starting point is based on the Company's revised revenue requirement filing of June 21, 2004, as discussed previously herein. Because of Staff's approach of adjusting the Company's filing in this manner, Staff Schedules A and A-1 show the lower 1.6876 revenue conversion factor in presenting the Company's filed amounts. However, in developing Staff's proposed revenue requirement, the correct effective Federal and State income tax rates have been used in quantifying overall revenue requirement and a further correction to the uncollectible rate, discussed by Mr. Brosch, results in Staff's proposed revenue conversion factor of 1.690976.

Q. Was the correction to the effective income tax rates brought to Staff's attention by the Company or was this information obtained as a result of Staff discovery?

A. During the review of the Company's June 2004 filing and cross-checking the effective tax rate calculations with the Arizona corporate tax return information (i.e., Form 120 and related instructions) at www.revenue.state.az.us, I identified this error which was confirmed via Staff Data Request UTI 15-18.

## CAPITAL STRUCTURE

Q. Could you identify the capital structure and cost rates proposed by Qwest in this proceeding?

A. Yes. Staff Schedule D sets forth the capital structure and cost rates recommended by both Staff and Qwest, which recognizes the recommendations of Staff witnesses Joel Reiker and Alejandro Ramirez.

Q. Is Staff's proposed weighted cost of capital consistent with the test year approach used in quantifying the other components of the ratemaking formula?

A. Yes, I believe so. It is my understanding that Staff's direct testimony discusses the consideration of financial data (e.g., debt issues and cost rates) involving changes that occurred subsequent to the 2003 test year.

Q. Does this conclude your direct testimony?

A. Yes.

# STEVEN C. CARVER
## SUMMARY OF QUALIFICATIONS

### Education and Experience

I graduated from State Fair Community College where I received an Associate of Arts Degree with an emphasis in Accounting. I also graduated from Central Missouri State University with a Bachelor of Science Degree in Business Administration, majoring in Accounting. Subsequent to the completion of formal education, my entire professional career has been dedicated to public utility investigations, regulatory analysis and consulting.

From 1977 to 1987, I was employed by the Missouri Public Service Commission in various professional auditing positions associated with the regulation of public utilities. In that capacity, I participated in and supervised various accounting compliance and rate case audits (including earnings reviews) of electric, gas and telephone utility companies and was responsible for the submission of expert testimony as a Staff witness.

In October 1979, I was promoted to the position of Accounting Manager of the Kansas City Office of the Commission Staff and assumed supervisory responsibilities for a staff of regulatory auditors, directing numerous rate case audits of large electric, gas and telephone utility companies operating in the State of Missouri. In April 1983, I was promoted by the Commission to the position of Chief Accountant and assumed overall management and policy responsibilities for the Accounting Department, providing guidance and assistance in the technical development of Staff issues in major rate cases and coordinating the general audit and administrative activities of the Department.

During 1986-1987, I was actively involved in a docket established by the Missouri Public Service Commission to investigate the revenue requirement impact of the Tax Reform Act of 1986 on Missouri utilities. In 1986, I prepared the comments of the Missouri Public Service Commission respecting the Proposed Amendment to FAS Statement No. 71 (relating to phase-in plans, plant abandonments, plant cost disallowances, etc.) as well as the Proposed Statement of Financial Accounting Standards for Accounting for Income Taxes. I actively participated in the discussions of a subcommittee responsible for drafting the comments of the National Association of Regulatory Utility Commissioners ("NARUC") on the Proposed Amendment to FAS

Statement No. 71 and subsequently appeared before the Financial Accounting Standards Board with a Missouri Commissioner to present the positions of NARUC and the Missouri Commission.

In July of 1983 and in addition to my duties as Chief Accountant, I was appointed Project Manager of the Commission Staff's construction audits of two nuclear power plants owned by electric utilities regulated by the Missouri Public Service Commission. As Project Manager, I was involved in the staffing and coordination of the construction audits and in the development and preparation of the Staff's audit findings for presentation to the Commission. In this capacity, I coordinated and supervised a matrix organization of Staff accountants, engineers, attorneys and consultants.

Since commencing employment with Utilitech in June 1987, I have conducted revenue requirement and special studies involving various regulated industries (i.e., electric, gas, telephone and water) and have been associated with regulatory projects on behalf of clients in twenty State regulatory jurisdictions.

**Previous Expert Testimony**

I have continued to appear as an expert witness before the Missouri Public Service Commission on behalf of various clients, including the Commission Staff. I have filed testimony before utility regulatory agencies in Arizona, California, Florida, Hawaii, Kansas, Indiana, Nevada, New Mexico, Oklahoma, Pennsylvania, Utah, and Washington. My previous experience involving major electric company proceedings includes: PSI Energy, Union Electric (now Ameren), Kansas City Power & Light, Missouri Public Service/ UtiliCorp United (now Aquila), Public Service Company of Oklahoma, Oklahoma Gas and Electric, Hawaiian Electric, and Sierra Pacific Power/ Nevada Power.

Exhibit SCC-2 summarizes various regulatory proceedings in which I have filed testimony.

**STEVEN C. CARVER**
**Summary of Previously Filed Testimony**
**1978 through 2004 (November)**

| Utility | Jurisdiction | Agency | Docket/Case Number | Party Represented | Year | Areas Addressed |
|---|---|---|---|---|---|---|
| Kansas City Power & Light | Missouri | PSC | ER-78-252 | Staff | 1978 | Rate Base, Operating Income |
| Gas Service Company | Missouri | PSC | GR-79-114 | Staff | 1979 | Rate Base, Operating Income |
| United Telephone of Missouri | Missouri | PSC | TO-79-227 | Staff | 1979 | Rate Base, Operating Income, Affiliated Interest |
| Kansas City Power & Light | Missouri | PSC | ER-80-48 | Staff | 1980 | Operating Income, Fuel Cost |
| Gas Service Company | Missouri | PSC | GR-80-173 | Staff | 1980 | Operating Income |
| Southwestern Bell Telephone | Missouri | PSC | TR-80-256 | Staff | 1980 | Operating Income |
| Missouri Public Service | Missouri | PSC | ER-81-85 | Staff | 1981 | Operating Income |
| Missouri Public Service | Missouri | PSC | ER-81-154 | Staff | 1981 | Interim Rates |
| Gas Service Company | Missouri | PSC | GR-81-155 | Staff | 1981 | Operating Income |
| Gas Service Company | Missouri | PSC | GR-81-257 | Staff | 1981 | Interim Rates |
| Union Electric Company | Missouri | PSC | ER-82-52 | Staff | 1982 | Operating Income, Fuel Cost |
| Southwestern bell Telephone | Missouri | PSC | TR-82-199 | Staff | 1982 | Operating Income |
| Union Electric Company | Missouri | PSC | ER-83-163 | Staff | 1983 | Rate Base, Plant Cancellation Costs |
| Gas Service Company | Missouri | PSC | GR-83-207 | Staff | 1983 | Interim Rates |
| Union Electric Company | Missouri | PSC | ER-84-168/ EO-85-17 | Staff | 1984 1985 | Construction Audit, Operating Income |

**STEVEN C. CARVER**
**Summary of Previously Filed Testimony**
**1978 through 2004 (November)**

| Utility | Jurisdiction | Agency | Docket/Case Number | Party Represented | Year | Areas Addressed |
|---|---|---|---|---|---|---|
| Kansas City Power & Light | Missouri | PSC | ER-85-128/ EO-85-185 | Staff | 1983 1985 | Construction Audit, Rate Base, Operating Income |
| St. Joseph Light & Power | Missouri | PSC | EC-88-107 | Public Counsel | 1987 | Rate Base, Operating Income |
| Northern Indiana Public Service | Indiana | IURC | 38380 | Consumer Counsel | 1988 | Operating Income |
| US West Communications | Arizona | ACC | E-1051-88-146 | Staff | 1989 | Rate Base, Operating Income |
| Dauphin Consol. Water Supply Co. | Pennsylvania | PUC | R-891259 | Staff | 1989 | Rate Base, Operating Income, Rate Design |
| Southwest Gas Corporation | Arizona | ACC | E-1551-89-102 E-1551-89-103 | Staff | 1989 | Rate Base, Operating Income |
| Southwestern Bell Telephone | Missouri | PSC | TO-89-56 | Public Counsel | 1989 1990 | Intrastate Cost Accounting Manual |
| Missouri Public Service | Missouri | PSC | ER-90-101 | Public Counsel/ Staff | 1990 | UtiliCorp United Corporate Structure/ Diversification |
| City Gas Company | Florida | PSC | 891175-GU | Public Counsel | 1990 | Rate Base, Operating Income, Acquisition Adjustment |
| Capital City Water Company | Missouri | PSC | WR-90-118 | Jefferson City | 1991 | Rehearing - Water Storage Contract |
| Southwestern Bell Telephone Company | Oklahoma | OCC | PUD-000662 | Attorney General | 1991 | Rate Base, Operating Income |
| Public Service of New Mexico | New Mexico | PSC | 2437 | USEA | 1992 | Franchise Taxes |
| Citizens Utilities Company | Arizona | ACC | ER-1032-92-073 | Staff | 1992 1993 | Rate Base, Operating Income |
| Missouri Public Service Company | Missouri | PSC | ER-93-37 | Staff | 1993 | Accounting Authority Order |

**STEVEN C. CARVER**
**Summary of Previously Filed Testimony**
**1978 through 2004 (November)**

| Utility | Jurisdiction | Agency | Docket/Case Number | Party Represented | Year | Areas Addressed |
|---|---|---|---|---|---|---|
| Public Service Company of Oklahoma | Oklahoma | OCC | PUD-1342 | Staff | 1993 | Rate Base, Operating Income, Acquisition Adjustment |
| Hawaiian Electric Company | Hawaii | PUC | 7700 | Consumer Advocate | 1993 | Rate Base, Operating Income |
| US West Communications | Washington | WUTC | UT-930074, 0307 | Public Counsel/ TRACER | 1994 | Sharing Plan Modifications |
| US West Communications | Arizona | ACC | E-1051-93-183 | Staff | 1994 | Rate Base, Operating Income |
| PSI Energy, Inc. | Indiana | IURC | 39584 | Consumer Counselor | 1994 | Operating Income, Capital Structure |
| Arkla, a Division of NORAM Energy | Oklahoma | OCC | PUD-940000354 | Attorney General | 1994 | Rate Base, Operating Income |
| Kauai Electric Division of Citizens Utilities Company | Hawaii | PUC | 94-0097 | Consumer Advocate | 1995 | Hurricane Iniki Storm Damage Restoration |
| Oklahoma Natural Gas Company | Oklahoma | OCC | PUD-940000477 | Attorney General | 1995 | Rate Base, Operating Income |
| US West Communications | Washington | WUTC | UT-950200 | Attorney General/ TRACER | 1995 | Rate Base, Operating Income |
| PSI Energy, Inc. | Indiana | IURC | 40003 | Consumer Counselor | 1995 | Rate Base, Operating Income |
| GTE Hawaiian Tel; Kauai Electric - Citizens Utilities Co.; Hawaiian Electric Co.; Hawaii Electric Light Co.; Maui Electric Company | Hawaii | PUC | PUC 95-0051 | Consumer Advocate | 1996 | Self-Insured Property Damage Reserve |

**STEVEN C. CARVER**
**Summary of Previously Filed Testimony**
**1978 through 2004 (November)**

| Utility | Jurisdiction | Agency | Docket/Case Number | Party Represented | Year | Areas Addressed |
|---|---|---|---|---|---|---|
| GTE Hawaiian Telephone Co., Inc. | Hawaii | PUC | PUC 94-0298 | Consumer Advocate | 1996 | Rate Base, Operating Income |
| Oklahoma Gas and Electric Company | Oklahoma | OCC | PUD-960000116 | Attorney General | 1996 | Rate Base, Operating Income |
| Public Service Company | Oklahoma | OCC | PUD-0000214 | Attorney General | 1997 | Rate Base, Operating Income |
| Arizona Telephone Company (TDS) | Arizona | ACC | U-2063-97-329 | Staff | 1997 | Rate Base, Operating Income, Affiliate Transactions |
| US West Communications | Utah | UPSC | 97-049-08 | Committee of Consumer Services | 1997 | Rate Base, Operating Income |
| Missouri Gas Energy | Missouri | PSC | GR-98-140 | Public Counsel | 1998 | Revenues, Uncollectibles |
| Sierra Pacific Power Company | Nevada | PUCN | 98-4062 98-4063 | Utility Consumers Advocate | 1999 | Sharing Plan |
| Hawaii Electric Light Co., Power Purchase Agreement (Encogen) | Hawaii | PUC | PUC 98-0013 | Consumer Advocate | 1999 | Keahole CT-4/CT-5 AFUDC, Avoided Cost |
| Kansas City Power & Light Company | Missouri | MoPSC | EC-99-553 | GST Steel Company | 1999 | Complaint Investigation |
| US West Communications | New Mexico | NM PRC | 3008 | PRC Staff | 2000 | Rate Base, Operating Income |
| Hawaii Electric Light Company | Hawaii | PUC | PUC 99-0207 | Consumer Advocate | 2000 | Keahole pre-PSD Common Facilities |
| US West/ Qwest Communications | Arizona | ACC | T-1051B-99-105 | Staff | 2000 | Rate Base, Operating Income |
| The Gas Company | Hawaii | PUC | 00-0309 | Consumer Advocate | 2001 | Rate Base, Operating Income, Nonreg Svcs. |

**STEVEN C. CARVER**
**Summary of Previously Filed Testimony**
**1978 through 2004 (November)**

| Utility | Jurisdiction | Agency | Docket/Case Number | Party Represented | Year | Areas Addressed |
|---|---|---|---|---|---|---|
| Craw-Kan Telephone Cooperative, Inc. | Kansas | KCC | 01-CRKT-713-AUD | KCC Staff | 2001 | Rate Base, Operating Income |
| Home Telephone Company, Inc. | Kansas | KCC | 02-HOMT-209-AUD | KCC Staff | 2002 | Rate Base, Operating Income |
| Wilson Telephone Company, Inc. | Kansas | KCC | 02-WLST-210-AUD | KCC Staff | 2002 | Rate Base, Operating Income |
| SBC Pacific Bell | California | PUC | 01-09-001 / 01-09-002 | Office of Ratepayer Advocate | 2002 | New Regulatory Framework / Earnings Sharing Investigation |
| JBN Telephone Company | Kansas | KCC | 02-JBNT-846-AUD | KCC Staff | 2002 | Rate Base, Operating Income |
| Kerman Telephone Company | California | PUC | 02-01-004 | Office of Ratepayer Advocate | 2002 | General Rate Case, Affiliate Lease, Nonregulated Transactions |
| S&A Telephone Company | Kansas | KCC | 03-S&AT-160-AUD | KCC Staff | 2003 | Rate Base, Operating Income, Nonreg Alloc |
| PSI Energy, Inc. | Indiana | IURC | 42359 | Consumer Counselor | 2003 | Rate Base, Operating Income, Nonreg Alloc |
| Arizona Public Service Company | Arizona | ACC | E-10345A-03-0437 | ACC Staff | 2004 | Rate Base, Operating Income |
| Qwest Corporation | Arizona | ACC | T-01051B-03-0454 & T-00000D-00-0672 | ACC Staff | 2004 | Rate Base, Operating Income |

**STEVEN C. CARVER**
**Summary of Previously Filed Testimony**
**1978 through 2004 (November)**

| Utility | Jurisdiction | Agency | Docket/Case Number | Party Represented | Year | Areas Addressed |
|---|---|---|---|---|---|---|
| Craw-Kan Telephone Cooperative, Inc. | Kansas | KCC | 01-CRKT-713-AUD | KCC Staff | 2001 | Rate Base, Operating Income |
| Home Telephone Company, Inc. | Kansas | KCC | 02-HOMT-209-AUD | KCC Staff | 2002 | Rate Base, Operating Income |
| Wilson Telephone Company, Inc. | Kansas | KCC | 02-WLST-210-AUD | KCC Staff | 2002 | Rate Base, Operating Income |
| SBC Pacific Bell | California | PUC | 01-09-001 / 01-09-002 | Office of Ratepayer Advocate | 2002 | New Regulatory Framework / Earnings Sharing Investigation |
| JBN Telephone Company | Kansas | KCC | 02-JBNT-846-AUD | KCC Staff | 2002 | Rate Base, Operating Income |
| Kerman Telephone Company | California | PUC | 02-01-004 | Office of Ratepayer Advocate | 2002 | General Rate Case, Affiliate Lease, Nonregulated Transactions |
| S&A Telephone Company | Kansas | KCC | 03-S&AT-160-AUD | KCC Staff | 2003 | Rate Base, Operating Income, Nonreg Alloc |
| PSI Energy, Inc. | Indiana | IURC | 42359 | Consumer Counselor | 2003 | Rate Base, Operating Income, Nonreg Alloc |
| Arizona Public Service Company | Arizona | ACC | E-10345A-03-0437 | ACC Staff | 2004 | Rate Base, Operating Income |
| Qwest Corporation | Arizona | ACC | T-01051B-03-0454 & T-00000D-00-0672 | ACC Staff | 2004 | Rate Base, Operating Income |

Witness: S. Carver
Prefiled Direct Testi

US WEST COMMUNICATIONS
DOCKET NO. T-1051B-99-105
RECONCILIATION OF POSITIONS
TEST YEAR ENDING DECEMBER 31, 1999
INTRASTATE (000's)



| LINE NO. | SCH./ ADJ. NO. | DESCRIPTION | AMOUNT | DIFFERENCE IN PRETAX RETURN | REVENUE REQUIREMENT VALUE |
|---|---|---|---|---|---|
| | | (A) | (B) | (C) | (D) |
| 1 | SCH. A | **USWC'S Revenue Requirement** | | | $201,221 |
| 2 | SCH. B | **Return Difference At USWC'S Rate Base** | $1,422,100 | -2.05% | (29,159) |
| 3 | | Subtotal Revenue Requirement | | | 172,062 |
| | | | | PRE-TAX RETURN | |
| 4 | | ACC STAFF RATE BASE ADJUSTMENTS | | | |
| 5 | B-1 | UNRECORDED RETIREMENTS | 0 | 13.99% | 0 |
| 6 | B-2 | SOP 98-1 (INTERNAL-USE SOFTWARE) | (7,417) | 13.99% | (1,038) |
| 7 | B-3 | FAS87 PENSION ASSET | (42,344) | 13.99% | (5,924) |
| 8 | B-4 | CASH WORKING CAPITAL | (9,469) | 13.99% | (1,325) |
| 9 | B-5 | PROFORMA DEPRECIATION -- RESERVE REVERSAL | 64,565 | 13.99% | 9,032 |
| 10 | B-6 | BROADBAND CABLE TRANSACTIONS (ASSET TRANSFER) | 6,791 | 13.99% | 950 |
| 11 | B-7 | FCC DEREG -- SEPARATIONS ADJUSTMENT | 1,061 | 13.99% | 148 |
| 12 | | Total Value of ACC Staff Rate Base Adustments | 13,187 | | 1,845 |
| 13 | | ACC Staff Rate Base Recommendation | $1,435,287 | | |
| 14 | SCH. A | USWC Net Operating Income | $43,833 | REVENUE CONVERSION MULTIPLIER | |
| 15 | | ACC Staff NET OPERATING INCOME ADJUSTMENTS | | | |
| 16 | C-1 | REVENUE ANNUALIZATION - RECURRING LOCAL SERVICE | 5,314 | 1.6995 | (9,032) |
| 17 | C-2 | ANNUALIZATION OF INTRASTATE TOLL REVENUES | 215 | 1.6995 | (366) |
| 18 | C-3 | REVERSAL OF ACCESS ANNUALIZATION | (1,091) | 1.6995 | 1,853 |
| 19 | C-4 | MISCELLANEOUS REVENUE NORMALIZATION | (881) | 1.6995 | 1,497 |
| 20 | C-5 | DIRECTORY IMPUTATION PER AGREEMENT | 24,722 | 1.6995 | (42,014) |
| 21 | C-6 | BROADBAND CABLE TRANSACTIONS | 950 | 1.6995 | (1,615) |
| 22 | C-7 | UNCOLLECTIBLES ANNUALIZATION | 61 | 1.6995 | (103) |
| 23 | C-8 | SERVICE QUALITY PROGRAM COST ELIMINATION | 5,747 | 1.6995 | (9,768) |
| 24 | C-9 | AFFILIATE TRANSACTION TRUE-UP NORMALIZATION | (650) | 1.6995 | 1,105 |
| 25 | C-10 | EOP NONLABOR REVERSAL | 5,751 | 1.6995 | (9,774) |
| 26 | C-11 | YEAR-END WAGE & SALARY ANNUALIZATION | 8,151 | 1.6995 | (13,852) |
| 27 | C-12 | INCENTIVE COMPENSATION | 3,253 | 1.6995 | (5,529) |
| 28 | C-13 | SOP 98-1 (INTERNAL-USE SOFTWARE) | 19,323 | 1.6995 | (32,840) |
| 29 | C-14 | USWC PAYROLL ADJUSTMENT REVERSAL | 7,839 | 1.6995 | (13,322) |
| 30 | C-15 | PROFORMA DEPRECIATION ANNUALIZATION | 1,763 | 1.6995 | (2,996) |
| 31 | C-16 | INTEREST SYNCHRONIZATION ADJUSTMENT | 46 | 1.6995 | n/a |
| 32 | C-17 | FCC DEREGULATED SERVICES REVENUE IMPUTATION | 2,128 | 1.6995 | (3,616) |
| 33 | C-18 | FCC DEREG -- SEPARATIONS ADJUSTMENT | (2,165) | 1.6995 | 3,680 |
| 34 | C-19 | PUBLIC AFFAIRS/RELATIONS EXPENSE DISALLOWANCE | 452 | 1.6995 | (768) |
| 35 | C-20 | US WEST INC. DEPARTMENTAL DISALLOWANCES | 683 | 1.6995 | (1,161) |
| 36 | C-21 | EMPLOYEE CONCESSION ALLOCATION TO INTERSTATE | 282 | 1.6995 | (479) |
| 37 | C-22 | DEPRECIATION ON UNRECORDED RETIREMENTS | 1,721 | 1.6995 | (2,924) |
| 38 | C-23 | RESERVED | 0 | 1.6995 | 0 |
| 39 | C-24 | PROPERTY TAX CORRECTION | 740 | 1.6995 | (1,258) |
| 40 | C-25 | OUT OF PERIOD PROPERTY AND OTHER TAXES | (1,233) | 1.6995 | 2,095 |
| 41 | C-26 | OUT OF PERIOD INCOME TAXES | 1,392 | 1.6995 | (2,365) |
| 42 | C-27 | IMAGE ADVERTISING, OLYMPIC/SPORTS SPONSORSHIP | 5,939 | 1.6995 | (10,092) |
| 43 | C-28 | RENT COMPENSATION | 99 | 1.6995 | (168) |
| 44 | C-29 | EXCHANGE SALE ALLOCATION ADJUSTMENTS | 6,717 | 1.6995 | (11,416) |
| 45 | C-30 | RECIPROCAL COMPENSATION | (6,830) | 1.6995 | 11,607 |
| 46 | C-31 | RESERVED | 0 | 1.6995 | 0 |
| 47 | C-32 | RESERVED | 0 | 1.6995 | 0 |
| 48 | C-33 | RESERVED | 0 | 1.6995 | 0 |
| 49 | | Total Value of ACC Staff Net Operating Income Adj. | 90,438 | | (153,620) |
| 50 | SCH. A | ACC Staff Net Operating Income Recommendation | $134,271 | | |
| 51 | | OTHER REVENUE REQUIREMENT DIFFERENCES | | | |
| 52 | | Bellcore 3 Year Adjustment | | | 0 |
| 53 | | Automatic Adjustment Revenue Requirement | | | (13,252) |
| 54 | | Total Other Differences | | | (13,252) |
| 55 | | RECONCILED REVENUE REQUIREMENT | | | $7,034 |
| 56 | | UNRECONCILED DIFFERENCE | | | 208 |
| 57 | SCH. A | **ACC STAFF REVENUE REQUIREMENT RECOMMENDATION** | | | $7,242 |

Attachment SCC-4

# QWEST CORPORATION
## DOCKET NO. T-01051B-03-0454
## Analysis of Pension Costs Included in Revenue Requirement
## (000'S)

| Year | ACC Docket | Order Date | Assumed Months in Effect | Arizona Intrastate: Ratemaking Pension Allowance (d) | Arizona Intrastate: Est. Pension Expense in Rates |
|---|---|---|---|---|---|
| 1987 | 84-100 | 1/10/86 | 12 | $ 12,200 | $ 12,200 |
| 1988 | 84-100 | | 12 | 12,200 | 12,200 |
| 1989 | 84-100 | | 2 | 12,200 | 2,033 |
| | 84-100 (a) | 3/1/89 | 10 | 12,200 | 10,167 |
| 1990 | 84-100 (a) | | 12 | 12,200 | 12,200 |
| 1991 | 84-100 (a) | | 6.5 | 12,200 | 6,608 |
| | 84-100 (b) | 7/15/91 | 5.5 | 12,200 | 5,592 |
| 1992 | 84-100 (b) | | 12 | 12,200 | 12,200 |
| 1993 | 84-100 (b) | | 12 | 12,200 | 12,200 |
| 1994 | 84-100 (b) | | 12 | 12,200 | 12,200 |
| 1995 | 93-183 | 1/3/95 | 12 | (9,000) | (9,000) |
| 1996 | 93-183 | | 12 | (9,000) | (9,000) |
| 1997 | 93-183 | | 12 | (9,000) | (9,000) |
| 1998 | 93-183 | | 12 | (9,000) | (9,000) |
| 1999 | 93-183 | | 12 | (9,000) | (9,000) |
| 2000 | 93-183 | | 12 | (9,000) | (9,000) |
| 2001 | 93-183 | | 3 | (9,000) | (2,250) |
| | 99-105 (c) | 4/1/01 | 9 | (9,000) | (6,750) |
| 2002 | 99-105 (c) | | 12 | (9,000) | (9,000) |
| 2003 | 99-105 (c) | | 12 | (9,000) | (9,000) |
| | | | | | **$ 16,600** |

**Footnotes:**

(a) Pension costs from Docket 84-100 assumed to continue due settlement in Docket 88-146.
(b) Pension costs from Docket 84-100 assumed to continue due settlement in Docket 91-400.
(c) Pension costs from Docket 84-100 assumed to continue due settlement in Docket 99-105.
(d) Qwest responses to Staff Data Request No. 3-10.

If negotiated settlements are treated as resolutions without any finding on specific costs and/or recoveries, a reasoned assumption would look to the results from the previous most recently litigated case to determine the amount of pension expense or credit.

**QWEST CORPORATION**
**DOCKET NO. T-01051B-03-0454**
**Analysis of Pension Costs Included in Revenue Requirement**
**(000'S)**

| Year | ACC Docket | Order Date | Assumed Months in Effect | Arizona Intrastate Ratemaking Pension Allowance (c) | Arizona Intrastate Est. Pension Expense in Rates |
|---|---|---|---|---|---|
| 1987 | 84-100 | 1/10/86 | 12 | $ 12,200 | $ 12,200 |
| 1988 | 84-100 | | 12 | 12,200 | 12,200 |
| 1989 | 84-100 | | 2 | 12,200 | 2,033 |
| | 88-146 (a) | 3/1/89 | 10 | (600) | (500) |
| 1990 | 88-146 (a) | | 12 | (600) | (600) |
| 1991 | 88-146 (a) | | 6.5 | (600) | (325) |
| | 91-004 (a) | 7/15/91 | 5.5 | (9,900) | (4,538) |
| 1992 | 91-004 (a) | | 12 | (9,900) | (9,900) |
| 1993 | 91-004 (a) | | 12 | (9,900) | (9,900) |
| 1994 | 91-004 (a) | | 12 | (9,900) | (9,900) |
| 1995 | 93-183 | 1/3/95 | 12 | (9,000) | (9,000) |
| 1996 | 93-183 | | 12 | (9,000) | (9,000) |
| 1997 | 93-183 | | 12 | (9,000) | (9,000) |
| 1998 | 93-183 | | 12 | (9,000) | (9,000) |
| 1999 | 93-183 | | 12 | (9,000) | (9,000) |
| 2000 | 93-183 | | 12 | (9,000) | (9,000) |
| 2001 | 93-183 | | 3 | (9,000) | (2,250) |
| | 99-105 (b) | 4/1/01 | 9 | (13,719) | (10,289) |
| 2002 | 99-105 (b) | | 12 | (13,719) | (13,719) |
| 2003 | 99-105 (b) | | 12 | (13,719) | (13,719) |
| | | | | | **$ (103,206)** |

**Sources:**

(a) Booked amount assumed as pension credit included in both settlements per Qwest response to UTI 20-5 in Docket T1051B-99-105.

(b) Intrastate pension credit included in the 1999 test year rate case (negotiated settlement silent on amount) per Qwest response to RUCO 28-3 in Docket T1051B-99-105.

(C) Qwest responses to Staff Data Request No. 3-10.

If negotiated settlements are not treated as resolutions without finding on specific costs and/or recoveries, the above tabulation would reflect the cumulative net pension credit conveyed to ratepayers -- even though three (3) proceedings were resolved by negotiated settlement.

Arizona
T-01051B-03-0454
UTI 03-001

INTERVENOR: Utilitech, Inc.

REQUEST NO: 001

Ref. Adjustment PFA-02 & supporting workpapers (OPEB). Columns (A) through (E) of Workpaper Attachment B shows the derivation of MR basis Intrastate OPEB expense recorded during the test year. Please provide the following:

a) Please provide a copy of the 12/31/03 "US WEST - REG." actuarial report supporting the amounts in Column (A).

b) Starting with the format and amounts set forth in Columns (A) through (E) of Attachment B, please provide a separate column for each offbook adjustment recorded by Qwest during the test year, showing a reconciliation of the MR basis Intrastate OPEB expense
(i.e., $51,798,543) with the jurisdictional (or JD) expense embedded in unadjusted test year expense.

RESPONSE:

a) Please refer to UTI 02-031 Confidential Attachment A - Qwest Postretirement Benefit Plan Regulated Companies. Medical Net Periodic Benefit Cost is shown in Section IV 1.C.; and Life Net Periodic Benefit Cost is shown in Section V 1.C..

b) Qwest recorded two OPEB jurisdictional difference adjustments in 2003 for Arizona. The first adjustment, BAC (OBK) 172, Post Retirement TBO Amortization, was removed from the test period in Adjustment PFA-02. The amount of this adjustment is shown on PFA-02 Workpaper Attachment A, Column (E). The second adjustment, BAC (OBK) 289, Postretirement Capital Reversal, is included in the test period. By keeping it in the test period the Company removes the amortized effect of pre-1992 capitalized OPEB costs embedded in the MR books that was created by early adoption of OPEB current service costs by the FCC, but not by Arizona. The adjustment was recorded as Other General Expense in 1992 and is being amortized for 17.3 years. The effect on JD expense for total year is $(130,746). PFA-02 Workpaper Attachment B is on an MR basis and therefore does not include offbook adjustments. All jurisdictional adjustments are recorded on an intrastate basis. If a schedule similar to PFA-02 Workpaper Attachment B were created, both offbook amounts would appear in column (E) and the reversal of Column BAC 172 would appear in Column (F). Only BAC 289 would appear in Column (G).

Respondent: Janice Franett, Qwest Manager

Arizona
T-01051B-03-0454
UTI 03-014

INTERVENOR: Utilitech, Inc.

REQUEST NO: 014

Ref. Grate direct, p. 54, & Adjustment PFA-02 (OPEB). The referenced testimony discusses Mr. Grate's proposed adjustment to reflect FAS106 accrual accounting for regulatory purposes. Please provide the following:

a) Please provide the amount of OPEB expense included in Qwest's unadjusted test year expense, showing allocation to intrastate operations and indicating the portion thereof attributable to either PAYGO or accrual basis accounting methods.

b) Referring to the referenced testimony, is it the Company's opinion that Qwest has never been allowed to recover FAS106 accrual basis costs through its Arizona intrastate rates? Please explain.

c) If the response to item (a) above indicates that unadjusted test year OPEB expense is not limited to PAYGO, please explain why Qwest recorded expenses greater than PAYGO.

RESPONSE:

a) Please refer to PFA-02 (OPEB) Attachment C Column L for OPEB expense included in Qwest's unadjusted test year expense and Column M for the allocation of intrastate expense. All of OPEB expense included in Qwest's unadjusted test year expense is on an accrual accounting basis.

b) Yes. In Docket No. E-1051-93-183, the Commission accepted Staff's and RUCO's proposal to not adoption SFAS 106 for ratemaking purposes and, instead, required the Company to use the PAYGO method of accounting for ratemaking purposes. Qwest is aware of no Commission order rescinding or reversing the position the Commission took in Docket No. E-1051-93-183 with regard to the use of SFAS 106 for ratemaking purposes. Qwest's response to UTI 03-04 is incorporated herein by reference.

c) Unadjusted test year OPEB expense is recorded on an accrual accounting basis in conformance with the FCC's Part 32 rules as required by Rule R14-2-510 G. The FCC adopted SFAS 106 effective January 1, 1992. Adjustment PFA-02 adjusts the 2003 test year OPEB expense to reflect adoption of SFAS 106 in the test year because, for ratemaking purposes, the Commission's decision in Docket No. E-1051-93-183 required Qwest to use the PAYGO method of accounting for OPEBs. The Commission has not reversed that position. See Qwest's response to UTI 3-04 and UTI 4-01. Adjusted OPEB test year expense is equal to the intrastate portion of booked cost plus adjustments to reflect adoption of SFAS 106 for ratemaking purposes in 2003 instead of 1992.

Please refer to PFA-02 (OPEB) Attachment B Column F for the differences between booked intrastate and Arizona Commission basis OPEB costs.

Respondent to parts a and c: Janice Franett

Respondent to part b: Phil Grate, Director - State Finance

Arizona
T-01051B-03-0454 and T-00000D-00-0672
UTI 18-007

INTERVENOR: Utilitech, Inc.

REQUEST NO: 007

Ref. Qwest's response to UTI 3-14 (OPEB). The responses to UTI 3-14 (a) and (c) describe Qwest's accounting for OPEB costs and indicate that Qwest's unadjusted test year OPEB expense is recorded on an accrual accounting basis, citing to FCC Part 32 rules and ACC Rule R14-2-510 G. The response to item (c) also refers to the Commission decision in Docket No. E-1051-93-183 requiring the PAYGO method for OPEB costs. Please provide the following:

a) It is unclear whether the Arizona intrastate test year starting point [see Company Schedule C-1, column (a)] includes OPEB costs on a PAYGO or accrual accounting basis. Please clarify and explain.

b) If the test year starting point [see Company Schedule C-1, column (a)] includes OPEB costs on a PAYGO basis, please provide the amount of Arizona intrastate PAYGO expense included in the test year starting point.

c) If the test year starting point [see Company Schedule C-1, column (a)] includes OPEB costs on an accrual accounting basis, please provide the amount of accrual basis expense included in the test year starting point.

d) If the responses to items (a) through (c) above indicate that Qwest recorded OPEB costs for Arizona intrastate regulatory purposes on an accrual basis, please explain why Qwest is utilizing accrual accounting, not PAYGO, to record such costs for Arizona regulatory accounting purposes.

RESPONSE:

Objection. This request is not reasonably calculated to lead to the discovery of admissible evidence concerning issues related to the modification, renewal or termination of the Price Cap Plan. Therefore, this request is overly broad and unduly burdensome because it seeks information beyond the scope of this proceeding. Without waiving this objection, Qwest provides the following response:

a) The Arizona intrastate test year starting point includes OPEB costs on an accrual accounting basis. Please see response to part (d).

b) Please see response to part (a).

c) Please see RUCO 03-010 Non-Confidential Attachment A PFA-02 "Intrastate as Booked", Column (C) for Arizona intrastate accrual accounting basis.

d) On an MR or FCC basis the Company records OPEB on an accrual accounting basis as adopted by the FCC in 1992. For Arizona intrastate regulatory purposes, the Company calculates intrastate PAYGO on a side-record. Because the Company is requesting regulatory approval to begin OPEB accrual accounting for Arizona intrastate regulatory purposes, the effect of adding and then subtracting PAYGO from the starting point is a wash. PFA-02 calculates the difference between OPEB intrastate as booked on an MR or FCC basis and proposed Arizona intrastate regulatory OPEB accrual accounting.

Respondent: Janice Franett, Qwest Manager

Arizona
T-01051B-03-0454 and T-00000D-00-0672
UTI 18-008

INTERVENOR: Utilitech, Inc.

REQUEST NO: 008

Ref. Qwest's response to UTI 3-14 (OPEB). The responses to UTI 3-14 (a) and (c) describe Qwest's accounting for OPEB costs and indicate that Qwest's unadjusted test year OPEB expense is recorded on an accrual accounting basis, citing to FCC Part 32 rules and ACC Rule R14-2-510 G. The response to item (c) also refers to the Commission decision in Docket No. E-1051-93-183 requiring the PAYGO method for OPEB costs. Please provide the following:

a) If Qwest has been recording OPEB costs on an accrual basis for Arizona intrastate regulatory purposes, please provide the amount amount of TBO (or APBO) amortization expense recorded during the test year.

b) Referring to item (a) above, please provide the aggregate amount of the TBO (or APBO) and the period of amortization on which the test year amortization expense was based. Please show all calculations and allocations to Arizona intrastate.

RESPONSE:

Objection. This request is not reasonably calculated to lead to the discovery of admissible evidence concerning issues related to the modification, renewal or termination of the Price Cap Plan. Therefore, this request is overly broad and unduly burdensome because it seeks information beyond the scope of this proceeding. Without waiving this objection, Qwest provides the following response:

a) The Company has not been recording OPEB costs on an accrual basis for Arizona intrastate regulatory purposes. On an Arizona intrastate regulatory basis no TBO (or APBO) amortization was recorded during the test year.

b) Please see response to part (a).

Respondent: Janice Franett, Qwest Manager

**QWEST CORPORATION**
**DOCKET NO. T-01051B-03-0454**

**FCC Deregulated Services**
**Test Year "Corrected" Financial Results**

| Product | Net Operating Income (Loss) | EOP Rate Base | Tariff?/ Basket |
|---|---|---|---|
| 1. Protocol Conversion | [redacted] | [redacted] | No |
| 2. Premises Services | [redacted] | [redacted] | Yes/3 |
| 3. Customer Dial Account Recording | [redacted] | [redacted] | No |
| 4. Voice Messaging | [redacted] | [redacted] | No/3 |
| 5. E911 Nonregulated | [redacted] | [redacted] | Yes/1 |
| 6. Information Services | [redacted] | [redacted] | No |
| 7. National Directory Assistance | [redacted] | [redacted] | Yes/3 |
| 8. Joint Marketing | [redacted] | [redacted] | No |
| 9. Unregulated Wholesale | [redacted] | [redacted] | No |
| 10. Unregulated Alarm | [redacted] | [redacted] | No |
| 11. Planning for Enhanced Services | [redacted] | [redacted] | No |
| Total FCC Dereg Services | [redacted] | [redacted] | |

**Source:** Qwest confidential response to Staff Data Request UTI 9-9, Attach. B.

**Note:** "Corrected" financial results refers to the cost reclassification Qwest identified in the response to Staff Data Request UTI 9-8, indicating that certain amounts charged to "Planning for Enhanced Services" should have been assigned to other FCC deregulated services – primarily payphone.

## QWEST CORPORATION
## DOCKET NO. T-01051B-03-0454

### FCC Deregulated Services
### Product Price Changes

| Product | General Price Change | Month | Tariff?/ Basket |
|---|---|---|---|
| 1. Protocol Conversion | | | No |
| 2. Premises Services | [redacted] | [redacted] | Yes/3 |
| 3. Customer Dial Account Recording | | | No |
| 4. Voice Messaging | [redacted] | [redacted] | No/3 |
| 5. E911 Nonregulated | | | Yes/1 |
| 6. Information Services | | | No |
| 7. National Directory Assistance | [redacted] | [redacted] | Yes/3 |
| 8. Joint Marketing | Various FDC pricing updates. | 10/01, 1/03, 1/04, 4/04 & 9/04 | No |
| 9. Unregulated Wholesale | | | No |
| 10. Unregulated Alarm | | | No |
| 11. Planning for Enhanced Services | | | No |

**Source:** Qwest responses to Staff Data Request UTI 9-6 & 9-7.

**Note:** Joint marking information was not designated confidential.

**BEFORE THE ARIZONA CORPORATION COMMISSION**

| | | |
|---|---|---|
| IN THE MATTER OF QWEST CORPORATION'S FILING AMENDED RENEWED PRICE REGULATION PLAN | ) ) ) | DOCKET NO. T-01051B-03-0454 |
| IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS | ) ) | DOCKET NO. T-00000D-00-0672 |

# DIRECT TESTIMONY

**OF**

**MICHAEL L. BROSCH**

**ON BEHALF OF THE STAFF OF THE ARIZONA CORPORATION COMMISSION**

**PUBLIC VERSION**

("Highlighted" Text Denotes Confidential Material)

**NOVEMBER 18, 2004**

## TABLE OF CONTENTS

## DIRECT TESTIMONY OF MICHAEL L. BROSCH



**Attachments**

## INTRODUCTION AND QUALIFICATIONS

Q. Please state your name and business address.

A. My name is Michael L. Brosch. My business address is 740 North Blue Parkway, Suite 204, Lee's Summit, Missouri 64086.

Q. By whom are you employed?

A. I am a principal in the firm Utilitech, Inc., a consulting firm engaged primarily in utility rate and regulation work. The firm's business and my responsibilities are related to special services work for utility regulatory clients. These services include rate case reviews, cost of service analyses, jurisdictional and class cost allocations, financial studies, rate design analyses and focused investigations related to utility operations and ratemaking issues.

Q. On whose behalf are you appearing in this proceeding?

A. I am appearing on behalf of the Arizona Corporation Commission Utilities Division Staff ("Staff"). Utilitech entered into a contract with the State of Arizona to review and respond to certain elements of the Filing of Renewed Price Cap Plan of Qwest Corporation ("Qwest or QC"). In particular, Utilitech was charged with responsibility for analysis and testimony regarding the test period 2003 adjusted earnings and revenue requirement of Qwest Corporation, employing the recommended rate of return sponsored by Staff witness Mr. Joel Reiker and recommended depreciation accrual rates sponsored by Staff witness Mr. William Dunkel. Mr. Steven Carver and I have prepared and jointly sponsor Staff's Accounting Schedules that are identified as Staff Joint Accounting Schedules, as more fully described in his testimony.

Q. Will you summarize your educational background and professional experience in the field of utility regulation?

A. My qualifications are summarized in Attachment MLB-1

I have testified before utility regulatory agencies in Arizona, Arkansas, California, Florida, Hawaii, Illinois, Indiana, Iowa, Kansas, Michigan, Missouri, New Mexico, Ohio, Oklahoma, Utah, Washington and Wisconsin in regulatory proceedings involving electric, gas, telephone, water, sewer, transit, and steam utilities. A listing of my past testimonies is set forth in Attachment MLB-2.

Q. Have you previously participated in Qwest or U S West Communications ("USWC") regulatory proceedings?

A. Yes, on many occasions. My firm has represented various clients in prior Qwest/USWC proceedings in several states. In Arizona, I participated in the last four Arizona general rate cases involving Qwest/USWC on behalf of the Arizona Corporation Commission Staff and supported the Staff in negotiating the Price Cap Plan in settlement of the most recent rate case.[1]

In Washington, I assisted the Washington Attorney General's Office, Public Counsel Section, in negotiation and subsequent review of that State's first Alternative Form of Regulation (AFOR) plan.[2] I was also a witness in the two subsequent Washington general rate cases involving USWC and in a 1998 proceeding dealing exclusively with directory imputation issues.[3] In New Mexico, I served as a witness for the Commission Staff in the most recent USWC rate case.[4] In Utah, I served as witness for the Committee of Consumer Services in USWC's last general rate case before commencing price cap regulation and sponsored the directory imputation amount approved by the Commission in that Docket.[5] I also represented consumer advocate clients in three states, Iowa, Utah and Washington in regulatory proceedings associated with the acquisition of USWC by Qwest.[6]

Most recently, I addressed issues raised by the sale of Qwest Dex in Arizona and two other states and assisted ACC Utilities Division Staff in the negotiated

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1 ACC Docket Nos. T-1051-88-146, T-1051-91-004, T-1051-93-183, and T-1051B-99-105

2 WUTC Docket Nos. U-89-2698-F and U-89-3245-P. Washington has since reverted to traditional cost of service regulation for Qwest.

3 WUTC Docket Nos. UT-950200, UT-970766 and UT-980948.

4 New Mexico PRC Case No. 3008.

5 Utah Public Service Commission Docket No. 97-049-08

settlement of that Arizona proceeding, which culminated in a Settlement providing for continued imputation of $72 million per year.[7]

Q. What is the purpose of your testimony in this Docket?

A. My testimony is intended to describe and sponsor, on behalf of the Staff, a series of accounting adjustments that should be made to the Company's revenue requirement R14-2-103 or "Rule 103" filing. The adjustments I sponsor are included in the Staff Joint Accounting Schedules, as listed in the Index page and at the top of specific Schedules therein.

## EXECUTIVE SUMMARY OF TESTIMONY

Q. Please summarize the recommendations that are set forth in your testimony.

A. The initial section of my testimony explains what the adjusted test period financial results of Qwest indicate about the Arizona Price Cap Plan in terms of the relative financial strength of the Company's Arizona operations and the apparent impact of competition upon financial results. I also describe financial reporting that should be beneficial to the Commission in any future reviews of Price Cap Plan performance.

The second major area covered in my testimony has to do with removal of certain costs that should not be charged to Qwest ratepayers, including corporate image advertising, extraordinary re-audit fees and insurance costs associated with Qwest's accounting investigations, certain public/legislative affairs expenses and excessive charges associated with Qwest Service Corporation senior management personnel. In addition, I have identified corrections to Qwest's filing to recognize updating of centralized and affiliate allocation factors in addition to Qwest's proposed updating of corporate headquarters factors. My final operating expense adjustment is to exclude certain excessive affiliate charges to QC, including consulting fees paid by an affiliate to the prior CEO and excessive prices charged by Qwest Wireless for cellular phone service.

[6] Utah PSC Docket No. 99-049-41, Iowa Case No. SPU-99-27, Washington Docket No. UT-991358.
[7] ACC Docket No. T-0105B-02-0666, Decision No. 66230.

My testimony next addresses the year-end annualization of Qwest's test period revenues. Qwest witness Mr. Philip Grate applied a linear regression analysis tool to monthly revenues in the various local service, access revenue, toll revenue and miscellaneous revenue accounts throughout a 36-month analysis period. Mr. Grate recognized the need to annualize revenues because the test period employs a year-end investment level to which the adjusted income statement should be "matched".[8] My testimony explains an inconsistency embedded throughout Qwest's originally filed revenue annualization adjustments caused by the failure to first restate the 36-month historical data to a "constant price" basis prior to applying regression calculations. This "constant price" restatement was accepted as a revision by Qwest and is necessary so as to avoid double counting the rate adjustments that are separately addressed in other adjustments in the Company's filing. However, even though Qwest agrees to correct for this global problem, my testimony explains several other concerns and proposes additional incremental adjustments to best capture ongoing revenues at the end of the 2003 test period, further adjusted for the price cap rate reductions implemented in April of 2004.

With regard to rate base, I have reviewed the Company's lead lag study of cash working capital and propose several adjustments to refine the lag day calculations included therein. I also explain in my testimony how the fair value rate base has been determined in Staff's filing, employing certain revisions to Qwest's Reproduction Cost New Less Depreciation ("RCND") study that are sponsored by Staff witness Mr. Dunkel.

Finally, my testimony explains why Staff's revenue conversion factor is different from Qwest's with regard to the uncollectible element of the factor, so as to incorporate Qwest's own uncollectible normalization adjustment in the determination of the factor.

Q. How is the balance of your testimony organized?

[8] Direct Testimony of Philip Grate, page 76.

A. My testimony is arranged by major topical area. A Table of Contents appearing at the beginning of the testimony sets forth this organization.

## PRICE CAP PLAN FINANCIAL PERFORMANCE

Q. Will Qwest's financial performance in Arizona continue to support access to capital markets on reasonable terms?

A. Yes. The primary indicator of financial health in terms of access to capital markets is the consistent generation of cash flows sufficient to cover fixed charges. The Arizona Intrastate operations of Qwest Corporation produce sufficient cash flows to service the allocated interest expense reasonably attributed to Arizona. On a pro-forma test period basis, Intrastate Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA") in Arizona exceeds $397 million annually in Staff's filing.[9] This measure of cash flow is well in excess of annual new construction expenditures of $198.5 million per Qwest's Schedule A-4 in its Rule 103 filing, and exceeds annual interest expense allocated to Arizona Intrastate operations of $66 million on Qwest's Schedule A-2 Detail.

Qwest continues to suffer from above-average debt leverage as a result of the protracted financial difficulties of the parent company and other non-regulated Qwest affiliates, but such difficulties do not arise from any failure of the Arizona Intrastate business of QC to produce consistent positive cash flows well in excess of debt service obligations.

Q. What does Staff's position regarding Qwest's revenue requirement tell us about the treatment of competition within the Arizona Price Cap Plan?

A. The initial Price Cap Plan was designed with a requirement that financial information be available in this Docket to provide a scorecard of financial performance for use in evaluating the terms of the Plan. Staff's quantification of Qwest's revenue requirement is neither a large positive, nor a significant negative value, supporting a

9 See Joint Staff Accounting Schedule C, Column D, Income from Operations of $186 million plus Depreciation Expense of $211 million.

general conclusion annual revenue are presently adequate to meet ongoing costs, after adjustment is made to reduce depreciation accrual rates.

With respect to competition, it is obvious that Intrastate revenues have declined considerably since the inception of the Plan, due to both volume reductions associated with competition and economic conditions as well as the price reductions implemented pursuant to the Plan. However, Qwest has managed to reduce its cost levels and maintain revenues at levels adequate to produce adequate returns on Intrastate rate base investment on after adjustments to normalize test year information. As noted above, Arizona Intrastate cash flows are strong and more than adequate to service the existing high debt levels reasonably allocated to Arizona.

Q. In the event the Commission approves continued use of a Price Cap form of regulation for Qwest in the future, should the Company be required to prepare and submit financial information indicating its achieved operating income, rate base and return on investment?

A. Yes. Intrastate earnings and revenue requirement data will continue to be useful in future Commission review and modification of Price Cap Plan regulation in Arizona. Therefore, during the term of any renewed Price Cap Plan, I recommend that, the Commission require annual filings each April 1 that report summarized earnings and revenue requirement data for each calendar year. These filings should present detailed test period intrastate earnings and rate base results prepared on a basis of accounting consistent with ratemaking principles established by the Commission, inclusive of the Commission's resolution of the following adjustments that should narrow disputed issues at that time:

- Imputation of $72 million of directory revenues
- Calculation of Depreciation expense/reserves at ACC approved rates
- Accrual basis accounting for OPEBs (per Carver testimony)
- Fixed cash working capital amount (per Brosch testimony)
- SOP 98-01 accounting for software (per Carver testimony)
- Pension asset in rate base (per Carver testimony)

- Treatment of FCC Nonregulated Services (per Carver testimony)

An understanding of traditional cost of service-based revenue requirement is necessary in any Price Cap review, in my opinion, in order to evaluate how alternative regulatory approaches are tracking with the underlying costs to provide service. This form of monitoring report would provide Staff with a periodic tracking tool to evaluate the financial performance of Qwest. In addition, such an analysis is important in assuring that regulators have sufficient financial data to understand how alternative regulation plan parameters are apportioning economic risks and opportunities between shareholders and customers – information that management tracks and can rely upon in formulating its alternative regulation recommendations. However, the filing of this information should not preclude the Staff or Commission from requesting the full R14-2-103 filing upon the Plan's termination if the Staff believes such a filing is necessary for complete evaluation of the Plan's effectiveness or to effectively review and evaluate the modifications proposed by Qwest.

## CORPORATE "IMAGE" ADVERTISING

Q. How are Qwest advertising expenses classified on the books?

A. Under FCC Part 32 Accounting Rules, advertising costs are classified into one of two accounts, as either "Product Advertising" or as non-product-related corporate image advertising contained within "External Relations" expense. FCC Part 32 Rules, define this distinction as follows:

Sec. 32.**6613** Product advertising.

> This account shall include costs incurred in developing and implementing promotional strategies to stimulate the purchase of products and services. This excludes nonproduct-related advertising, such as corporate image, stock and bond issue and employment advertisements, which shall be included in the appropriate functional accounts.

Sec. 32.**6722** External relations.

> This account shall include costs incurred in maintaining relations with government, regulators, other companies and the general public. This includes:
> (a) Reviewing existing or pending legislation (See also account 7370, Special Charges, for lobbying expenses.);

> (b) Preparing and presenting information for regulatory purposes, including tariff and service cost filings, and obtaining radio licenses and construction permits;
> (c) **<u>Performing public relations and non-product-related corporate image advertising activities</u>**;
> (d) Administering relations, including negotiating contracts (See also Account 6725, Legal.), with telecommunications companies and other utilities, businesses, and industries. This excludes sales contracts (See also Account 6612, Sales.); and
> (e) Administering investor relations. [emphasis added]

In the test period, Qwest Corporation incurred large amounts of both product-specific as well as corporate image advertising.

Q. How has the Commission historically treated each type of advertising costs incurred by the Company?

A. Staff has not challenged Qwest's incurred costs for Account 6613 Product Advertising in prior rate cases and such costs have been allowed by the Commission. However, for Corporate Image Advertising charged to Account 6722, Staff has consistently recommended disallowance of the costs because they are designed to promote a favorable public image, rather than promote specific regulated telephone products and services.

In the 1994 rate case, Docket No. E-1051-93-183, Qwest's own filing eliminated about $1.2 million of "Corporate Brand Advertising" that was incurred in the test year.[10] Decision No. 58927 in that Docket adopted the Company-proposed full disallowance of image advertising direct costs that were not in dispute, and also adopted a 50 percent disallowance of certain additional parent company indirect support costs for media relations, public relations planning and creative services that were challenged by Staff:

> In response, Staff indicated that the majority of USWI's public relations efforts are designed to promote a favorable public image. The direct costs of these efforts have been disallowed by Staff and generally agreed to by the Company. As a result, Staff asserted it

[10] Staff Accounting Schedule C-17 in Docket No. E-1051-93-183 reflects Staff's adjustment to remove certain US West parent-allocated costs, in addition to the Company's own adjustment removing "Corporate Brand Advertising" in the amount $1.226 million.

> would be inconsistent to not also disallow indirect costs of support such as medial [sic] relations, public relations planning, and creative services.
>
> We generally agree with Staff that the company shareholders are normally the beneficiaries of various public relations, legislative and image advertising. However, the Company has listed activities being provided by various support groups which do provide benefits to ratepayers. We recognize that some of these indirect costs of support would promote certain direct costs which we have disallowed. As a result, we will disallow 50 percent of Staff's proposed disallowance or $43,737 for media relations, public relations planning, and creative services. We will approve the remaining portion of Staff's proposed disallowance of $522,178 for public affairs and public relations costs. The net result would be a disallowance of $478,441. (Decision page 31)

In the 1999 rate case, Staff recommended disallowance of the Company's image advertising along with costs of sponsorship for sports teams and the Olympics. The Company disputed Staff's adjustments in that case, arguing that increased competition justified recovery of such costs. Because of the Settlement Agreement, no ACC Decision addressed the disputed image advertising costs in the 1999 rate case.

Q. Is Qwest disputing the Commission's policy established in the 1994 rate case Decision in its Rule 103 filing in this Docket?

A. Yes. The Company has made no ratemaking adjustment to remove its corporate image advertising in the 2003 test year. Company witness Mr. Grate states his opposition to such an adjustment at page 131 of his testimony, "Qwest believes that the costs it incurs for advertising, including image advertising are appropriate in the competitive marketplace in which it operates in Arizona. The testimony of David L. Teitzel details the breadth and depth of competition Qwest faces in Arizona. Unless another party comes forward with clear and convincing evidence that the cost of Qwest's image advertising is not a reasonable expenditure under current market conditions or is dishonest or obviously wasteful, it should not be disallowed."

Q. Has the Commission or Qwest, in prior cases where image advertising costs were removed, applied any of the new "current market conditions", "dishonesty" or "obviously wasteful" criteria that Mr. Grate now seeks to impose?

A. Not to my knowledge. Nor has Mr. Grate offered any "clear and convincing evidence" in support of his proposed change in regulatory policy regarding such costs.

Q. How much image advertising was incurred by Qwest and included in Arizona expenses for the 2003 test year?

A. According to Qwest's confidential response to Data Request UTI 2-19, Arizona recorded on the books approximately [redacted] of corporate advertising expenses, the majority of which were incurred and allocated by the Qwest Services Corporation headquarters entity. A central theme of Qwest's corporate image advertising is telling customers that Qwest provides good customer service, as part of its so-called "Spirit of Service" message and brand tagline. Messages within the advertisements include characterizations of Qwest companies with phrases such as:

- Always there for you
- We Know our Customers
- Our Spirit of Service
- We're On our Way (to timely serve customers)
- It's a Team Effort

Most of the allocations from QSC of corporate marketing and advertising costs are driven by the relative sales or revenues earned by Qwest Corporation, versus other affiliated entities selling long distance, wireless, customer premise equipment or data networking services. I have attached as Attachment MLB-3, a copy of Qwest's print corporate image advertising in the test period.

Q. How much product specific advertising was incurred by Qwest and included in Arizona expenses in the 2003 test year?

A. In addition to the corporate advertising expenses noted above, the Company incurred and booked another [redacted] in product specific advertising expenses for the promotion of specific products such as packaged business services, consumer service bundles with telephone lines, features like caller ID and voicemail, and with wireless and/or long distance services and advertisements for high-speed DSL services.

Q. Have you prepared a table comparing Qwest Arizona advertising costs by category over the past several years?

A. Yes. The costs charged to advertising expense, particularly corporate brand advertising, have fluctuated considerably over the past four years[11]:

Arizona Advertising Costs by Category$000

| | 2000 | 2001 | 2002 | 2003TY |
|---|---|---|---|---|
| Product Advertising | [redacted] | [redacted] | [redacted] | [redacted] |
| Corporate Brand Advertising | [redacted] | [redacted] | [redacted] | [redacted] |
| Total Advertising - AZ Share | [redacted] | [redacted] | [redacted] | [redacted] |
| Less: Disallowed Brand Advertising | [redacted] | [redacted] | [redacted] | [redacted] |
| Allowable Advertising | [redacted] | [redacted] | [redacted] | [redacted] |

It should be noted that the full amount of expenses charged to "Corporate Brand Advertising" on the books are shown as "Disallowed Brand Advertising" in the years 2001 and 2002, but in 2003, Staff's adjustment is to remove only a portion of the charges to Account 6722.2 Corporate Brand Advertising. This is because the Company recorded all of the advertising charged to QC by the QSC affiliate as "Corporate Brand Advertising", even though the majority of such charges were related to product promotion rather than brand promotion.[12] What remains as

[11] Confidential Attachments UTI 18-04A, UTI 15-21A, UTI 4-29A and UTI 18-03A.

[12] UTI 15-21A, Note 2 explains, [redacted]

"Allowable Advertising" after Staff's adjustment in the 2003 test year compares reasonably to allowable expense amounts in prior years.

Q. In the previous chart, the amount of "Disallowed Brand Advertising" is less than the total amount of "Corporate Brand Advertising". What is the cause of this difference?

A. Staff has taken a very conservative view of what advertising should be considered brand or image advertising in quantifying the proposed disallowance. Qwest has indicated that corporate advertising allocated from Qwest Services Corporation to QC and recorded as corporate brand advertising is actually mis-classified on the books, because much of this activity and cost should actually be considered product advertising.[13] Staff has accepted this management representation in quantifying the proposed adjustment, even though this result is inconsistent with recorded information.

Q. Please explain the reasons why corporate image advertising should not be included in Qwest's Arizona Intrastate ratemaking expenses that are recoverable from ratepayers.

A. There are several general policy and other Company-specific reasons why image advertising should not be allowed for Qwest in this proceeding:

- Expenditures made to promote favorable public opinion, such as charitable contributions, image advertising and event sponsorship are discretionary costs that are not required to provide regulated services and provide no tangible direct benefit to the Company or its customers.
- Image advertising is no substitute for consistent provision of high quality regulated services and simply providing good service at reasonable rate levels will contribute to favorable public opinion with no need for self promotion within image advertising.
- If the reputation of a regulated entity has been harmed by poor service quality or questionable business practices, customers of regulated services should not be required to bear image advertising costs designed to improve the corporate image.

[13] Qwest responses to Data Request 4-20 and 18-04, Attachment A.

- Image advertising is redundant to product specific advertising that is used by telephone companies to promote specific services – product specific advertising can be used to maintain public awareness of the availability and value associated with using regulated products and services.
- Promotion of the corporate brand or image may provide a subsidy for non-regulated services offered by corporate affiliates as a result of either the incurrence of costs not needed for the regulated business or because of excessive allocation of such costs to the regulated entity.
- Test year image advertising cost levels were increased relative to prior years, in an apparent effort to enhance Qwest's reputation, credibility and image after experiencing widely publicized financial difficulties, accounting investigations and senior management turnover.

For these reasons, Staff is recommending elimination of Qwest corporate image advertising that was allocated to Arizona operations in the test period. This proposed elimination is consistent with ACC precedent established in prior rate cases involving Qwest, as noted above.

Q. You noted that in the 1993 rate case, Qwest included a ratemaking adjustment to exclude its incurred corporate advertising costs. Does increased competition or do other changed circumstances justify inclusion of corporate advertising costs at this time?

A. No. There has always been a degree of competition facing many of Qwest's regulated products and services and Staff has always been supportive of rate recovery for product specific advertising to promote regulated services. However, the Company's reputation and public image can best be promoted by providing consistently high quality regulated services and avoiding corporate acts damaging to the firm's business reputation. It is not reasonable to burden ratepayers of regulated services with corporate image advertising costs simply because markets have become more competitive.

Q. Does Qwest Corporation realize substantial public exposure for its brand name and corporate identity at no incremental cost by virtue of its incumbent local exchange telephone company ("ILEC") status?

A. Yes. The Company has a business and/or consumer connection with a majority of households and businesses in Arizona simply by being the ILEC. Monthly billing statements are branded by Qwest and customers pay their bills to Qwest. The Company's vehicles and buildings display Qwest's brand name and logo and each call center, internet contact, service call and other customer contact exposes the public to the Qwest brand.[14] Considerable brand recognition benefit is realized by Qwest Corporation and its non-regulated affiliates within the 14 state service territory of Qwest Corporation as a result of the Company's ILEC status.

Q. Does Qwest Corporation receive any compensation for the brand awareness arising from its ILEC business operations from the QCII parent entity or the other subsidiaries of QCII that sell long distance, wireless or other competitive services?

A. No. The Qwest companies share a common brand name, marks and business reputation with no compensation or transfer payments, aside from the allocation and sharing of corporate marketing and advertising activities that are incurred by Qwest Services Corporation for the common benefit of all affiliates. According to the Company's response to Data Request UTI 6-16, "Qwest Services Corporation manages all advertising costs for the family of Qwest Companies. Advertising costs are not tracked by affiliate at an advertising campaign level. It would require an extensive special study to provide this information."

Q. Did Staff attempt to evaluate Qwest advertising costs in detail, so as to understand the basis for attributing different types of ad costs among the Qwest family of companies?

[14] Qwest response to UTI 18-06.

A. Yes. However, despite numerous questions and attempts to understand how Qwest categorizes and manages the costs of advertising and other marketing, the Company was not able or was unwilling to produce information in formats useful for such an analysis.[15] I was unable to conclude, from the information produced by Qwest, whether the cost assignments and allocation factors used to apportion corporate advertising and marketing costs among affiliates was reasonable. In particular, it appears that allocations based upon the relative size of revenue streams among affiliates would disadvantage Qwest Corporation's mature ILEC business with large and stable revenue streams resulting in higher cost allocations, to the potential benefit of newer and more rapidly growing wireless and long distance business segments.

Q. Has the Company produced any information supporting the notion that Qwest's corporate image advertising should now be included in test period expenses?

A. No. Aside from Mr. Grate's testimony stating his opinion that increased competition justifies full recovery of such costs, no information has been produced analyzing Qwest marketing or demonstrating the need for, or quantifying any benefits arising from, such activities. Clearly, the Company understood ACC policy with respect to image advertising, yet no studies, analysis, reports or other cost/benefit information were included in the Company's filing on this issue.

In its response to Data Request UTI 4-29, the Company argues for a burden of proof upon Staff in the area, stating, "In its last rate case, image or brand advertising was disallowed because the Commission considered it unnecessary to the provision of telephone service in the 1992-1993 test year. The costs of brand advertising is not disallowable unless a party comes forward with clear and convincing evidence that shows why, under an appropriate standard of disallowance, it should be disallowed. Qwest is aware of no evidence that its test year brand advertising was unnecessary or imprudent in the 2003 test year, which was characterized by significant competition for telephone service and significant access line losses. Accordingly, a disallowance of unnecessary brand advertising in the 2003 test year yields an adjustment of zero."

[15] See, for example, Data Requests UTI 1-12S1, UTI 2-18S1, UTI 2-19S1, UTI 2-20, UTI 6-15, UTI 6-

Q. Is there evidence that Qwest's corporate advertising costs were incurred in response to the Company's widely publicized financial problems, accounting investigations, restatements of financial reports and replacement of senior management, so as to re-establish corporate credibility and improve the corporate public image?

A. Yes. In a highly confidential report titled "The Qwest Report – Draft First Quarter 2003 Results", provided in response to RUCO Data Request No. 2-72 that Staff was allowed to review but not copy in Denver, the following narrative was included:

[redacted]

The Company's [redacted] may be attributed to past service quality problems, or the accounting investigations and restatements or the senior management replacements that have occurred, but cannot be attributed to actions of Arizona ratepayers. Therefore the costs of advertising designed to [redacted] need not be funded by ratepayers.

In its response to Data Request UTI 4-30, Qwest produced as Confidential Attachment A a document titled [redacted] and is included as confidential Attachment MLB-4 to this testimony. It documents that [redacted] also illustrates the nature and origin of the corporate image problems that Qwest was trying to overcome with its

16 and UTI 14-03, which all ask for cost breakdowns of advertising to accommodate Staff analysis.

corporate brand advertising and clearly shows why ratepayers should not be held accountable for such costs.

Q. Earlier in this section of your testimony, you presented a table illustrating the growth in corporate image advertising that occurred in the test period, relative to prior years. Were their any particular months in the test period with concentrated advertising expenditures?

A. Yes. In the last two months of the test year, November and December of 2003, the Company recorded [redacted] of corporate advertising expense. This represents about 42 percent of total annual expenses for the entire year. Then, in the first five months of 2004, expenditures declined to a range of [redacted] per month, with a total year to date expense in 2004 of [redacted] Thus, it would appear that, if corporate advertising were judged recoverable from ratepayers over Staff's objections, a more normal run rate for corporate advertising in all months other than November and December 2003 would support a downward normalizing adjustment of at least [redacted] to total Arizona expenses.

Q. Did Qwest produce any studies of its corporate image, branding, customer perceptions or positioning in the marketplace prior to the decision to commence the "Spirit of Service" campaign and prior to the large increase in expenditures for image advertising in 2003?

A. Yes. In July 2002, a [redacted]. This confidential document was produced in response to Data Request UTI 14-6 as Attachment B and is included in its entirety as Attachment MLB-5 to my testimony. This document clearly shows that the problems and concerns causing Qwest to increase its image advertising and engage in the "Spirit of Service" campaign relate to issues arising from Qwest's self-inflicted damage to its public reputation and not concerns properly attributed to customers of QC regulated services in Arizona.

Q. Please explain Staff Joint Accounting Schedule C-9.

A. This Staff Adjustment removes test period corporate image advertising, based upon allocations performed by Qwest to segregate such amounts in the response to Data Request UTI 4-29, confidential Attachment A.

## PUBLIC AFFAIRS & COMMUNITY RELATIONS COSTS

Q. What activities are undertaken by the Company's Public Policy Personnel?

A. Qwest Services Corporation staffs a Public Policy Organization that is responsible for the [redacted].[16] This organization defines and carries out the Company's [redacted]. This structure incorporates [redacted]. Each [redacted]. Additionally, [redacted] within a centralized Public Policy Organization that [redacted].

Q. Does the Company include the costs of its regulatory, community relations and legislative affairs activity within its operating expenses and asserted revenue requirement?

A. For the most part, yes. In the Arizona Public Policy Organization, only the direct costs of lobbying, including all test period labor and benefits charges for the [redacted], were charged below the line as "lobbying" costs, to be borne by shareholders rather than customers. As a result, the test period revenue requirement includes other costs associated with line management supervision of this position, corporate planning and support of legislative advocacy, as well as incurred costs for Community Affairs personnel and local event sponsorship and for managing Qwest Foundation grants.[17]

Q. What is the purpose of the adjustment set forth on Staff Joint Accounting Schedule C-14?

A. This adjustment excludes additional costs within the Arizona Public Affairs organization that appear to [redacted].[18] Staff's proposed disallowance can be considered conservative, because it does not reach above the Arizona Public Affairs organization, even though corporate-level Public Policy executives and QSC support staff are also clearly involved in the development and administration of such advocacy at the State level.

Q. Why should costs incurred by Qwest involving public and legislative affairs not be included within above-the-line expenses and fully recovered from ratepayers?

A. When regulated companies engage in public affairs issues, both ratepayer and shareholders may benefit, but the interests of shareholders are a fiduciary responsibility of management in dealing with such issues. The costs of monitoring and attempting to maintain relationships and influence legislation are routinely disallowed by regulators. Staff's proposal in this instance is to provide some above-the-line recovery of costs to represent ratepayers' interests regarding legislative and

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[16] UTI 4-11, Confidential Attachments A and B.
[17] Qwest response to UTI 4-11B and UTI 6-10.
[18] UTI 4-09, Confidential Attachment A.

regulatory issues of concern, while increasing the likelihood that lobbying and public affairs support costs are not excessively charged to ratepayers.

Q. What approximate percentage of Qwest's Arizona Public Policy Organization wage and benefit costs were recorded below the line as lobbying costs in the test period?

A. Approximately [redacted] percent of Arizona Public Policy Organization costs were charged below the line in the test year, even though a primary role of Public Policy is the [redacted].[19]

Q. Is there also a corporate Public Policy Organization that engages in Federal legislative affairs matters?

A. Yes. The principle responsibility for Federal legislation rests with five persons in the QSC corporate Public Policy organization, including Qwest's Vice President of Federal Relations, its Director Legal Issues, the Vice President of Government Relations, the Director Legal Issues and Senior Staff Advocate. Notably, about [redacted] percent of the salary and benefits cost for these QSC positions was charged to below-the-line lobbying accounts[20], a much higher percentage than was considered lobbying by Qwest within the Arizona Public Policy organization. Staff has proposed no further adjustment to the Qwest corporate Public Policy organization.

Q. Is the Public Affairs adjustment you propose for the Arizona Public Policy group consistent with disallowances approved by the Commission in prior Qwest rate proceedings?

A. Yes. In the last litigated Arizona rate case in 1993, I sponsored a similar disallowance that was addressed by the Commission at page 45 of Decision No. 58927 in Docket No. E-1051-93-183, with the following discussion:

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[19] Confidential responses to UTI 1-19, Attachment A, indicates Public Policy charges above the line to Arizona Account 6722.9 from Qwest Services Corporation totaling [redacted] charged below the line as "lobbying".

[20] Confidential Attachment B to Data Request UTI 18-2 indicates [redacted] in salary and benefits costs was charged to Below-the-Line Account 7370.3.

> The Company incurs certain public policy organization costs related to public affairs and public relations personnel. A portion of these costs are accounted for below the line to recognize the need for shareholders funding of lobbying, charitable contributions, and other community welfare programs. The Company defined the below-the-line activities as expenditures for the purpose of advocating the Company's position to the public or to public officials with respect to legislation, referendum, or ordinances. During the TY, the Company recorded only six percent of overall public policy organization expenses below the line.
>
> Staff reviewed various position descriptions provided by the company and concluded that the Company's recording of only six percent of overall public policy costs below-the-line was unreasonable. Staff asserted that legislative/public affairs and image enhancement expenditures are not necessary to provide telephone service. Further, Staff indicated that the Company has failed to provide justification of the assignment of the public affairs/public relations costs to the ratepayers. As a result, Staff recommended that 50 percent of the public affairs and public relations costs be disallowed. Staff's recommendation would reduce TY expenses by $615,000.
>
> We concur with Staff. The Company has not justified over 94 percent of the public affairs and public relations costs being passed through to ratepayers. These are areas which clearly provide benefit to shareholders. We find that Staff's proposal to split the costs between ratepayers and shareholders to be a fair resolution.

The adjustment proposed by Staff in this proceeding is again a partial disallowance of Qwest's Arizona public affairs supervisory and support function costs, based upon the ratio of legislative and external/community relations direct costs to total public policy costs incurred in the test period. The details of the ratio calculation are set forth in Confidential Schedule C-14. Staff's adjustment effectively disallows about 48 percent of Arizona Public Policy wage and benefit costs, with no disallowance of corporate supervisory and administrative support personnel shared with the other states.

Q. Did you inquire into the nature of legislative positions undertaken by Qwest to see if the Commission's past conclusions regarding benefits to shareholders remain valid today?

A. Yes. Data Request UTI 6-11 asked if the Qwest Public Policy Organization prepares or participates in the preparation of strategic plans or other formally documented planning processes that are submitted for review and approval by senior management and, if so, to provide copies of all such documentation. The Company responded "No" and provided no documentation.

To evaluate Qwest's legislative activities beyond directly assigned lobbying costs that are booked below the line, Staff submitted Data Requests UTI 9-14 and 9-15 asking Qwest for "any records associated with its legislative activities, its assessment of pending legislation or its position on legislative matters" at the State and Federal levels, respectively. In reply to both questions, the Company stated, "Qwest objects to this data request on the grounds that the request violates Qwest's First Amendment rights of free speech and to petition the government by seeking information with respect to Qwest's actions taken in lobbying, its assessments of legislation and its position with respect to legislation. Qwest also objects that the request seeks in part information that is protected by the attorney client and work product privileges."

Q. Should the adjustment Staff has proposed to disallow a portion of Public Policy costs be considered conservative and generous to shareholders?

A. Yes. Rather than disallow 50 percent of Qwest Service Corporation charges to Account 6722 External Relations expenses in the test period, Staff proposes a more detailed adjustment. Specifically, a disallowance of two Director position salaries and a pro-rated share of the related supervisory wage and benefit costs within the Public Policy Organization to below the line accounts is proposed, based upon position descriptions and the supervisory relationship of management personnel over such positions. This results in a relatively modest adjustment that does not disallow any of Qwest's corporate Public Policy support personnel, even though to some extent they are involved in support of State legislative activities.

## EXTRAORDINARY ACCOUNTING AND INSURANCE COSTS

Q. Did Qwest incur certain extraordinary costs in the test period as a result of various investigations and litigation surrounding the validity of its accounting records and the propriety of its public disclosures?

A. Yes. The Qwest Corporation SEC Form 10Q filed May 5, 2004 describes a series of investigations, lawsuits and asserted claims against Qwest Corporation and its parent company, that are described under the headings "Securities Action" and "Investigations" and "Securities Actions and Derivative Actions". I have attached as Attachment MLB-6, a copy of this documentation. According to these disclosures, the SEC investigation, "...includes, without limitation, inquiry into several specifically identified QCII accounting practices and transactions and related disclosures that are the subject of the various adjustments and restatements described in the QCII annual report in Form 10-K for the year ended December 31, 2002. The investigation also includes inquiry into disclosure and other issues related to transactions between QCII and certain of its vendors and certain investments in the securities of those vendors by individuals associated with QCII." A U.S. Attorney's Office investigation into similar matters is also discussed, along with U. S. Congressional hearings that have occurred. With knowledge of these recent and pending matters, Staff inquired of the Company regarding related test period costs that may be included in the asserted revenue requirement.

In a supplemental response to Data Request UTI 1-24, the Company stated, "All external legal costs for Special Litigation referred to in the 10-Q were recorded on QCII's books and not QC's books. The disclosure was included in QC's 10-Q because, as a subsidiary of QCII, QC may be impacted by any judgments or fines QCII is required to pay in the future. Internal legal costs associated with these litigations were incurred at Qwest Services Corporation and allocated and billed back to QC. See Confidential Attachment A for the QC Arizona intrastate amounts associated with these internal legal costs." Upon review of these costs, Staff concluded that QC internal charge amounts allocated to Arizona in the test period were minimal and required no adjustment.

However, additional costs associated with the extraordinary investigation and litigation involving Qwest were incurred for the re-auditing of prior years' financial statements and for vastly increased costs for directors and officers ("D&O") liability insurance. Staff is proposing adjustments to normalize for these extraordinary costs that are included within the test year expenses and in the Company's Rule 103 filing.

Q. Please describe Staff's adjustments associated with Qwest's activities in response to the investigations and litigation you reference.

A. Staff Joint Accounting Schedule C-12 sets forth three adjustments, first to remove the direct costs associated with re-auditing prior years' financial statements, then to remove costs associated with shareholders litigation and finally to restate the Arizona share of Qwest's Directors and Officers ("D&O") Liability Insurance to a normalized level. The sources for the amounts included for these adjustments are Qwest's confidential responses to UTI 1-26, UTI 1-24 and UTI 11-13, respectively. A normalized level for the D&O insurance costs was determined to be the highest cost level incurred in any of the three years prior to the 2003 test period.

Q. Were any of the accounting restatements resulting from the re-auditing activity that were reflected in Qwest's publicly filed SEC financial statements for 2002 or 2003 associated with the books of Qwest Corporation, the regulated utility?

A. No.[21]

Q. Was the overall level of accounting services costs in the test year much higher than incurred costs in prior years as a direct result of the extraordinary costs associated with re-auditing previously audited and reported financial periods?

A. Yes.[22] The Arizona Intrastate share of accounting fees in 2003 was approximately [redacted] percent higher than comparable costs in 2002. Staff's adjustment is conservative in light of the magnitude of this cost increase, because it removes the discrete costs of additional accounting fees, leaving within the test year

[21] Qwest Supplemental Response to UTI 1-27S1.

any additional labor, contractor and other expenses incurred to support Qwest's response to the various investigations and lawsuits that were active in 2003.

Q. With respect to the costs of D&O insurance incurred by QCII, is it fairly obvious that insurance costs have increased as a direct result of pending claims against Qwest and its officers?

A. Yes. In 2002, the year the SEC and U.S. Attorney's investigations and most of the putative class actions were commenced, and in the two years prior to 2002, the cost of D&O insurance incurred by QCII for the entire business never exceeded [redacted] million, with approximately [redacted] allocated to Arizona Intrastate expenses.[23] There is reference in the Qwest Corporation SEC Form 10-Q to "$200 million of insurance proceeds" related to such proceedings. Starting in 2003, D&O insurance premiums paid by QCII were increased to about [redacted] million, of which more than [redacted] is allocated to Arizona intrastate operations. Clearly, these costs are extraordinary and should be normalized.

## UPDATED ALLOCATION FACTORS

Q. Did Qwest include in its filing an adjustment to update certain allocation factors to January 2004 levels?

A. Yes. Qwest adjustment PFN-06 is captioned "Headquarters Factors Update" and has the effect of restating allocations recorded during the 2003 test year as if the new factors that were effective on January 1, 2004 had been effective throughout the test year. In his testimony at page 51, Mr. Grate describes this adjustment as:

- PFN-06, adjusting "headquarters" allocated expenses to reflect the multi-state allocation factors most reflective of the end of the test year;

Mr. Grate provided additional details for this adjustment at pages 93 and 94 and explains, "In a nutshell, headquarters factors are declining in Arizona because Qwest is losing customers significantly faster in Arizona than in other states."

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22 Qwest response to UTI 5-06, Attachment A.
23 Qwest response to UTI 11-13, Confidential Attachment A.

Q. Do you agree with this adjustment and explanation?

A. I agree that the adjustment should be made, but would observe that there are more variables than simply customer counts that impact the adjustment. Most of the headquarters costs being allocated are actually subjected to a "weighted three" factor that includes a combination of access lines, telecommunications plant in service and expense values among the states to derive the factor. Thus, Mr. Grate's explanation of apparent trends ignores the role of relative expenses and investment in determining the factor. More importantly, his adjustment is incomplete in that it fails to make corresponding adjustments for the shifts in regional "centralized" factors or for the updated Qwest Services Corporation allocation factors that were also made effective on January 1, 2004.

Q. What is Qwest Services Corporation and how does it employ relative size-based allocation factors to attribute costs to Qwest Corporation's Arizona operations?

A. Qwest Services Corporation ("QSC") is an affiliated company that provides centralized executive, administrative, marketing and technical services on a shared basis for the various subsidiaries of Qwest Communications International, Inc. ("QCII"). In this capacity, QSC incurs labor and non-labor costs that are accumulated within responsibility centers ("RCs") which then assign or allocate such costs among affiliated companies, including Qwest Corporation. In the test year, the Qwest Corporation "share" of QSC allocated charges was approximately [redacted], or about [redacted] percent of total QSC costs of [redacted].[24] While some QSC costs are directly assigned or attributed among affiliates based upon positive time reporting (timesheets), most of the costs are allocated using a series of allocation factors that are periodically updated to reflect more current financial and statistical indicators of the relative size of QC versus the other QCII affiliates.

Q. Please explain the adjustment set forth at Staff Joint Accounting Schedule C-13.

[24] Derived from Confidential Attachment A to Data Request UTI 1-21.

A. This Schedule adjusts for the impact upon test period QSC charges if one simply updates the relative size-based QSC allocation factors to January 2004 levels. In keeping with the philosophy of Qwest's PFN-06 updating of headquarters pro-rate factors within Qwest Corporation, there should be a comparable updating of the QSC allocation factors to the same point in time. This adjustment relies upon information contained in Qwest's confidential responses to Data Requests UTI 8-44 and 8-46, with confidential details redacted in the detailed calculations within Schedule C-13.

Q. At line 40 of Staff Joint Accounting Schedule C-13, there is reference to "Centralized" allocations. What are "centralized" allocation factors?

A. Many of Qwest Corporation's employees are directly assigned to a particular state, while others are "headquarters" employees that work for the benefit of all 14 states. Another category of personnel and costs are for regional or centralized employees and functions that benefit more than one state, but less than all 14 states. There are a series of relative size-based "centralized" allocation factors that should have also been updated as of January 1, 2004 by Mr. Grate.

Q. Have you quantified the adjustment needed to update for the centralized allocation factors, in a manner consistent with Qwest's PFN-06 updating of headquarters factors?

A. Yes. Actually, Qwest was asked to perform these calculations and they were provided to Staff in response to Data Request UTI 2-008. The ratemaking adjustment that is set forth in Staff Joint Accounting Schedule C-13 includes the Company's calculation of the impact of updated centralized allocation factors upon test period charges to Arizona.

## QWEST SERVICE CORPORATION COSTS

Q. In previous testimony regarding other adjustments, you referenced corporate advertising costs and public policy costs that were incurred by Qwest Service Corporation ("QSC") and then allocated to Qwest Corporation and other affiliates.

Are there other costs incurred at QSC that require adjustment for ratemaking purposes?

A. Yes. Staff Joint Accounting Schedule C-15 sets forth one other element of QSC expenses charged to QC Arizona operations in the test period that requires adjustment. This cost involves consulting payments made to Qwest's former Chief Executive Officer pursuant to his "Resignation and Consulting Agreement". Staff does not believe these costs are reasonable or necessary for the provision of service in Arizona.

Q. Please explain the consulting payments made to Qwest's former CEO, Mr. Nacchio, that are disallowed in Staff Joint Accounting Schedule C-15.

A. Mr. Joseph Nacchio was Qwest's CEO during the years when significant accounting problems, financial investigations, a precipitous decline in credit ratings and disastrous financial performance were experienced. Ultimately, QCII and Mr. Nacchio entered into a "Resignation and Consulting Agreement" dated as of June 16, 2002 that provided for his resignation and the termination of an existing Employment Agreement, as well as payment of a lump sum $10.5 million severance benefit, continuation of pension, welfare and medical benefits, continued indemnification and insurance payments, disposition of certain stock-based compensation and an ongoing consulting arrangement.[25] This latter provision caused Qwest to pay Mr. Nacchio $125,000 per month through June 30, 2004 to serve as a consultant to the Company "with respect to transitional matters relating to the Company's business, and shall perform such other services for the Company, its subsidiaries and affiliates as reasonably requested by the Board during the Consulting Period."

Staff has disallowed these consulting payments to the prior CEO, as allocated to Arizona, because Qwest has made no showing that any services of benefit to QC in Arizona were received from Mr. Nacchio and because no ongoing services are to be provided upon expiration of the agreement.

[25] Qwest response to Data Request UTI 15-23, Non-confidential Attachment C.

## QWEST WIRELESS AFFILIATE PRICING

Q. Please explain the purpose of Staff Joint Accounting Schedule C- 10.

A. This adjustment is made by Staff to "re-price" cellular phone charges paid by Qwest Corporation to its wireless affiliate, Qwest Wireless, so as to reduce per minute pricing to the lowest and best prices Qwest Wireless charges certain large, non-affiliated customers. Qwest Corporation incurs significant costs for internal communications among its employees using cellular phones and has selected Qwest Wireless as its vendor for such services. The effect of Staff's adjustment in this area is to reduce actual test year wireless charges that were priced at $.08 per minute to the lower "GOLD" plan pricing paid by other Qwest Wireless customers of only $.05 per minute.[26]

Q. What is the stated basis for Qwest Wireless pricing of cellular phone services to Qwest Corporation?

A. According to Qwest's response to Data Request UTI 3-26, Qwest Wireless pricing is based upon Prevailing Company Price –"the price that is billed to existing customers for service with the similar features and similar volumes. Generally, these prices are included in the company's billing systems for non-affiliate customer billing. For each PCP service, 25% of the revenue must be from outside parties." A confidential Attachment B to the same Data Request indicated that third party customers of Qwest Wireless pay a wide variety of nominal and effective per minute of use ("MOU") prices for service and that several of such customers were paying prices lower than Qwest Corporation was being charged by its wireless affiliate in the test year.

Q. How does Qwest explain charging the regulated business higher per MOU prices for wireless service than Qwest Wireless charges non-affiliated large customers?

A. Staff requested an explanation in Data Request UTI 7-10. In its response, the Company offered a listing of Current Price Plans for wireless service broken down between "MOU Plans" and "Fixed Plans" that charge a per phone recurring charge

[26] Qwest response to Data Request UTI 7-10, Non-confidential Attachment A.

with an allowance of free minutes. The lowest priced 'MOU Plan" was a grandfathered "GOLD" plan that has no monthly recurring per phone charge and a flat rate of $.05 per minute for usage. In the narrative response to this request, Qwest stated that, "As indicated in Non-Confidential Attachment A, QW no longer offers most of these plans. In many instances, QW has permitted existing customers to retain the more attractive plans because of the revenue those customers generate for other Qwest products (including regulated products)."

The Company admitted in this response that, "QW bills QC at a higher nominal rate per MOU than the identified third parties. However, a full evaluation of the cost of wireless service must consider other factors besides the nominal rate per MOU. For example, in order to receive discounted units, third party customers must agree to either a one-year or two-year contract for each wireless line they purchase; QC has no obligation to sign contracts and, thereby, avoids the cost of administering contracts. Third party customers who terminate service prior to the end of the contract period pay a $200 deactivation fee; QC pays nothing for deactivation prior to the end of a one year or two year time period." The Company also offered a comparison showing QC prices superior to two other currently offered Fixed Plans, but no comparison was offered to the grandfathered GOLD plan.

Q. Who are the third party wireless customers that receive the lower GOLD plan prices?

A. According to Qwest's response to Data Request UTI 16-19, "Gold Plan customers are business customers that purchased the plan when it was available to new customers. This plan was not actively marketed to business customers after 2002. In 2004, when QW began migrating customers to the Sprint Network, QW did not require these customers to choose another plan because the company wanted to retain them and the revenue they generate for all Qwest products." Non-confidential Attachment C to this response lists 46 customers that commenced "Gold Plan" service between September of 1998 and August of 2001, of which 17 have since discontinued Gold Plan service as of September of 2004.

There is no explanation given for why Qwest Corporation did not purchase this lower priced plan while it was available or why the wireless affiliate seems less concerned about "retaining" QC as a wireless customer.

Q. Did Staff ask the Company to quantify its avoided service deactivation fees by taking wireless service under the higher priced plan during the test period?

A. Yes. Staff was interested in understanding whether QC realized any offsetting benefits in the form of avoided deactivation fees, in return for paying higher per minute prices. In response to Data Request UTI 16-19f, the Company stated, "Charges other than deactivation fees would have been the same under the Gold Plan as under QC's actual agreement with Qwest Wireless (QW). Deactivation fees that QC avoided by being on the 8 cent plan cannot readily be determined because QC's contract expiration date, required for this calculation, is not present on QW's databases. An extensive special study would have to be performed to gather the necessary information to calculate QC's avoided deactivation fees."

Q. How is Staff's adjustment to reprice wireless service purchased from the QW affiliate quantified?

A. Schedule C-10 reflects a simple reprice of the MOU in the test year at the lower five cents per minute Gold Plan rate. If Qwest can document the avoided "deactivation fees" that is would have paid under the Gold Plan, such fees would be an appropriate offset to Staff's ratemaking adjustment.

## CASH WORKING CAPITAL

Q. How has Qwest determined its Cash Working Capital estimate for inclusion in rate base?

A. The Company compiled a lead-lag study of cash working capital. A lead-lag study measures the timing of cash flows through the company, so as to determine whether cash is collected from customers more quickly or more slowly than the Company is required to pay its employees, vendors, taxing authorities and creditors. If the Company can collect its revenues more quickly than it must pay its expenses, a negative cash working capital value is included in rate base, so as to recognize that the Company can finance part of its operations from favorable timing of operational cash flows. Alternatively, if revenue collection occurs more slowly than expenses must be paid, a positive rate base value for cash working capital is recognized, so as to provide additional return amounts to service the additional capital required of investors.

Q. What is Qwest's asserted cash working capital for rate base inclusion?

A. In its Rule 103 filing, at Schedule B-1, Qwest included negative $32.17 million of cash working capital in both the original cost and fair value rate base. However, the Company agreed to correct this value to negative $52.2 million after Staff identified a problem with the Qwest study that caused it to inadvertently include certain non-cash expenses including depreciation, deferred taxes and net income (return on common equity).[27]

Q. Are the Company's proposed corrections to its lead lag study result included in the Staff Joint Accounting Schedules?

A. Yes. Schedule B-1 incorporates the revisions Qwest would make to its asserted Rate Base in the Rule 103 filing. The single most significant rate base adjustment is the correction to cash working capital to remove the effects of non-cash expense elements that were inadvertently included.

Q. What other adjustments has Staff made to the Company's lead lag study?

A. The Company made certain simplifying assumptions in estimation of lag days to be applied to payroll costs, employee benefit costs and a portion of interest expense. With respect to payroll, the amount of gross pay was assumed to be subject to lag days associated with actual payments made to employees. However, a significant portion of payroll dollars are actually withheld for payment of payroll taxes, 401k savings plan contributions and other payroll deductions. Staff has refined the

[27] Data Request UTI 2-13. The Company also made other, less individually significant corrections in this

composite payroll lag day value for the estimated pay dates associated with these withholding items, using estimates of actual cash disbursement timing for each individually significant item. Additionally, Qwest included incentive compensation payments with a very long assumed lag in payment in its computation of the payroll lag and Staff has removed this element, so as to conform with the recommendation to eliminate most of the costs for test year incentive compensation.

Another area modified by Staff involves the computation of certain employee benefit lag days. Qwest assumed in its lead lag study that a zero payment lag day is properly applied to pension and group insurance expenses. Staff conducted additional discovery in this area and has more specifically analyzed and computed lag days to replace the assumed zero value, based upon estimated cash flow timing associated with such payments. For self-insured medical, dental, pharmaceutical and vision claims for both active and retired employees, Staff estimated the payment lags based upon the timing of claims paid.

With respect to payroll taxes, Qwest has treated Federal Unemployment Taxes as if the front-loading effect caused by the low annual taxable wage base causes these taxes to be significantly prepaid in relation to when employees actually accrue such costs and benefits. Staff has revised this calculation to reflect a FUTA tax payment lag equal to the FICA tax lag, since regulations governing tax remittances for these items are identical.

Another Staff lag day adjustment relates to interest payments. Qwest has included debt issuance expense amortization expenses with an assumed "zero" payment lag day value. However, debt issuance expense is a non-cash expense comparable to debt discount and premium amortization. Rather than include the expense with a zero expense lag, this expense element should be treated the same as Qwest's treatment of discount and premium amortization, by setting the expense lag equal to the revenue lag to yield no impact upon cash working capital.

Finally, the Staff lead lag study is tied to pro-forma expense levels associated with Staff's adjusted test period revenue requirement. This causes Staff's result to

Data Request response and provided revised workpapers reflecting such corrections.

more directly linked to relevant costs used to set rates and is an improvement upon the Company's study that incorporates unadjusted per books expense levels.

Q. Does Staff Joint Accounting Schedule B-2 incorporate the lag day modifications described in your testimony?

A. Yes. The lag days in Column E for many of the expense rows in Schedule B-2 have been modified to reflect revisions made by Staff to the underlying wage and benefits lag days. The specific rows affected are noted in footnote 1. The modified interest payment lag appears at line 22 of Schedule B-2.

## LOCAL NETWORK SERVICES REVENUES

Q. What are Local Network Services Revenues and how are they treated in determining revenue requirement?

A. Local Service Revenues are derived from providing various services to retail end-user customers that rely upon the local exchange. These include recurring and non-recurring charges for basic local telephone services such as 1FR and 1FB lines, as well as a multitude of secondary features like call waiting, caller ID and call forwarding as well as local directory assistance. The recurring monthly charges associated with many of Qwest's basic local service revenue types enable revenues to be annualized at the end of the test period by simply multiplying recorded revenues in December times twelve. Along with Qwest's other smaller categories of intrastate revenues, such as access revenues, toll revenues and miscellaneous revenues, it is important to quantify a reasonable, ongoing level of revenues at present rate levels in order to determine whether existing rates are sufficient, excessive or inadequate relative to the Company's overall cost to serve.

In Arizona, the ratemaking formula employs an end-of-period rate base. This means that in this Docket the net amount capital investment in the Company's Telecommunications Plant in Service is measured at December 31, 2003. Additionally, depreciation expense is annualized at December 31, 2003 and any other known expense level changes at that date should also be recognized to properly synchronize all measures of the Company revenue requirement. In past rate cases, Staff has insisted that increasing trends in the Company's overall sales volumes and revenues be considered as of the same date rate base is measured. In this Docket, Qwest appears to agree with Staff that revenues should be annualized at year-end.

Q. Does "annualization" of revenues at test year-end intend to adjust for sales volumes at that date as well as price changes that have occurred?

A. Sales volumes need to be annualized at year-end, so as to match sales and customers at that date with the amount of plant investment and expenses required to meet that level of demand. The revenue impact of price changes, on the other hand, must be updated to current data if one is to determine whether "present" rate levels are inadequate or excessive. For this reason, Qwest has proposed separate adjustments in its Rule 103 filing to quantify revenue reductions associated with ACC-Ordered rate changes as of April 1, 2003 and at April 1, 2004 and intends its revenue annualization adjustments to account for only the annual volume of sales being experienced at year-end.[28]

Q. How are Local Network Services Revenues treated in the Company's R14-2-103 filing?

A. In Qwest's Rule 103 filing, the Company has proposed an adjustment to annualize declining revenue trends as of December 2003, in an attempt to match the cutoff of sales and revenues with the timing of rate base measurement. However, unlike Staff's annualization methods used in prior cases, Qwest employed a more complex analytical approach based upon linear regression. Recorded revenues in each individually significant revenue account were analyzed over an extended 36 month period; in a multi-step process that process that is described generally at pages 76 through 91 of Mr. Grate's Direct Testimony in support of Qwest's Adjustment PFN-

[28] An acknowledged problem with Qwest's Adjustment PFN-03 is the failure to separate volume from price level changes in the underlying data that is subjected to linear regression. This problem was conceded in Qwest's response to Staff Data Request No. UTI 2-06, "...the Company agrees that all price changes that occurred during the 36 month regression period should have been reflected in the regression data revenue stream. The company will supplement its response to this request when it has completed the analysis required to reflect this change."

03. Under Qwest's new approach, monthly financial data for a 36-month period January 2001 through December 2003 is first reviewed to identify any known out-of-period transactions requiring normalization. Then, Qwest applied data regression procedures to determine if a particular independent variable "driver" statistic over the same 36-month period can be reliably used to predict a year-end revenue level. Where the selected "driver" produces acceptably high sum of the residuals or "R-squared" result and sufficiently high T-test statistics indicating a meaningful correlation, Mr. Grate has calculated a predicted December 2003 revenue value that is multiplied times 12 months to annualize revenues.

Q. How does Qwest's new approach compare with the approach Staff has used in prior Qwest rate proceedings for local service revenues?

A. The Staff's approach to annualize revenue accounts containing <u>recurring</u> monthly local service revenue accounts has been to carefully remove or normalize any accounting abnormalities from the recorded data in the last month of the test period and then multiply the "last month" data by twelve to annualize. For example, in Docket No. T-1051B-99-105, Staff's Joint Accounting Schedule C-2 illustrates how I normalized December 1999 recorded local recurring revenues within 14 specified sub-accounts and then multiplied by twelve (months) to calculate an annualized ongoing revenue level at year end for these recurring local revenue accounts.

For accounts containing revenues that are <u>not</u> driven by recurring monthly charges to customers, such as access revenues or intraLATA toll revenues that are priced primarily on a per minute of use ("MOU") basis, the Staff has in past rate cases analyzed usage and revenue trends and generally applied a "fourth quarter times four" approach to annualize revenues if a trend in revenue is clearly present. This alternative annualization method was also applied only after carefully reviewing the recorded revenue data within the annualization quarter to be sure no unusual or out-of-period transactions would introduce any distortion into the resulting adjustment.

Q. Mr. Grate must have been aware of the Staff's past rate case methodology. How does he explain his preference for the more complex 36-month normalization and regression technique he employs?

A. At page 88 of his testimony, Mr. Grate compares his technique to the Staff's prior rate case methodology using Account 5001.21 recurring residential local service revenues as an example. After noting that his linear regression method would yield "an adjustment of $22,170,201" for this Account, Mr. Grate states:

> Had I multiplied normalized December revenues by twelve, the resulting annual revenues would have been $252,468,116 and the corresponding adjustment would have been $21,914,129. Though the results of multiplying the last month of the test period by twelve and using regression analysis are quite close, regression analysis is the clearly superior annualization methodology.
>
> Only the regression analysis method eliminates the risk of introducing distortion into the data that can occur when any unidentified anomalies in a single month's financial data are multiplied by twelve. The risk of such anomalies is most pronounced in the month of December, which is the last month of the fiscal year and so subject to year end true-ups and accruals.
>
> The advantage of a properly conducted linear regression analysis over multiplication of a limited sample (one month's or one quarter's worth) of financial data is that linear regression analysis relies on drivers that are less subject to anomalies and more likely to be representative of end-of-period conditions than are end-of-period financial data. Hence, regression analysis is more likely to yield results that are representative of end-of-period conditions than is multiplication of December financial data by twelve.

In the instance of this single account, the difference in methodology is relatively insignificant. However, in other accounts the linear regression approach now advocated by Qwest produces a less reliable annualized revenue result than alternative methods that will be explained in my testimony.

Q. In the last rate case, did Qwest concur in Staff's longstanding use of a one-month-times-twelve approach to annualize recurring local service revenues?

A. Yes. Mr. Grate acknowledges at page 90, "In Qwest's last rate case, Mr. Redding adjusted the test year so that each account reflected the recorded amount of financial results in the last month of the test period multiplied by twelve." He then distinguishes the Company's changed philosophy in stating, "In this filing the adjustments are made based on statistically meaningful and reliable drivers at the end of the test period. Using drivers instead of as-recorded actual financial results avoids the introduction of anomalies or unusual entries that may be present in just one month's financial data."

It should be noted that Mr. Redding also applied his "last month times twelve" method indiscriminately to many revenue and non-labor expense accounts in the last case, producing results that were found unreasonable and were rejected by Staff. Mr. Carver will address necessary adjustments to annualize expenses to year-end in his testimony.

Q. Is Qwest's new revenue annualization approach necessarily more accurate or reasonable than reliance upon a single month or quarter of financial data?

A. Not necessarily. Either the Staff or Company approach can produce reasonable results if carefully applied to relevant data. Qwest's new regression approach employs more data points and introduces a trending or smoothing effect into the calculations, which tends to reduce the dependence upon any single month of data. However, this smoothing may dilute the weight given the most recent financial data and underlying sales trends of greatest importance in annualizing sales volume changes occurring during the last six months of the test year. Inclusion of more historical data also brings with it an obligation to critically analyze much more information to identify and properly normalize for unusual, non-recurring or out-of-period entries in each of the 36 financial data points as well as any aberrations in 36 months of the so-called "driver" statistics. Additionally, over extended periods of time, changes in accounting procedures, regulatory requirements, prices of specific services and shifts in overall levels of economic activity can become embedded in the regression results, even though such historical changes have little to do with recent changes in demand and sales volumes from the average or mid-point of the test period to year-end. I believe we should be concerned with the reasonableness of the end-result of the annualization, in relation to actual factual data, and not rigidly apply a calculation process that may produce results inconsistent with reality.

Q. Is there a fundamental problem with Mr. Grate's regression approach that causes the prefiled Qwest Adjustment PFN-03 amounts to be inaccurate?

A. Yes. In separate adjustments PFN-02 and PFN-04, Mr. Grate has reduced test year revenues to account for ACC-ordered Price Cap Plan revenue reductions effective on April 1, 2003 and on April 1, 2004, respectively. Staff has reviewed and does not dispute these price level adjustments. Unfortunately, the 36 months of recorded revenue data relied upon by Mr. Grate for regression analysis also reflects declining prices associated with these same rate reductions, as well as certain other pricing changes incorporated in early 2001 at the inception of the Price Plan. The changing and generally declining price levels embedded in the 36 months of financial data influence the regression-derived revenue trend coefficients in Qwest's prefiled PFN-03 adjustment, which has the effect of distorting Mr. Grate's intended calculation of a volume only revenue annualization. Stated differently, Qwest's prefiled Adjustment PFN-03 tends to overstate declining revenue trends because the underlying revenue data is impacted by Price Cap rate reductions ordered by the Commission that are already included in Qwest Adjustments PFN-02 and PFN-04. Thus, the Price Cap rate reductions are double counted in PFN-03 because the embedded revenue amounts used for linear regression reflect declining prices that tend to exaggerate the actual downward trend in sales volumes.

Q. Has Qwest admitted this problem and submitted to Staff revisions to its PFN-03 Adjustment that the Company believes should be reflected in its revenue requirement?

A. Yes. In its Supplemental Response to Data Request UTI 2-06, the Company provided revisions to its PFN-03 adjustment workpapers. Then, in response to Data Request UTI 7-02, Qwest concurred in the posting of revisions to its filing that are set forth at Staff Joint Accounting Schedule C-1.

Q. What is the purpose of Staff Joint Accounting Schedule C-1?

A. This Schedule is included in Staff's filing simply to reflect a series of adjustments Qwest now recognizes as appropriate revisions to its filing, so as to avoid the need for a formal revision to the Company's R14-2-103 information. These are Company proposed revisions, arising primarily from information revealed in responding to Staff data requests. By posting these adjustments, Staff is not concurring in all of the Company's revisions, but merely updating the information in the Company's Rule 103 filing that is used as a starting point for the Staff Joint Accounting Schedules. In fact, in testimony Mr. Carver and I sponsor, some of Qwest's revisions are disputed and subjected to further adjustment.

Q. Given the nature of the double counting problem in Qwest's regression calculations associated with the price reductions ordered by the Commission, why does the Company's proposed revision to the PFN-03 regression adjustment to revenues not significantly change the amount of the adjustment?

A. The Company has now, upon revision, expanded the scope of its initial adjustment. The corrections made by Qwest to all of the "regulated" intrastate revenue accounts have the effect of increasing adjusted test year revenues, as expected. However, Qwest also seeks to now include FCC Deregulated revenue trends within its adjustment. These changes were not part of the Company's prefiled PFN-03 Adjustment. The following table compares Qwest's prefiled versus revised adjustment by primary revenue account, illustrating this expansion of scope.

| **Revenue Trending PFN-03 Revisions** | | Revised $000 | Original $000 | Impact $000 |
|---|---|---|---|---|
| Local Service | Recurring | [redacted] | [redacted] | [redacted] |
| | Non-Recurring | [redacted] | [redacted] | [redacted] |
| | Directory Assistance | [redacted] | [redacted] | [redacted] |
| Access Revenues | | [redacted] | [redacted] | [redacted] |
| Toll Revenue | | [redacted] | [redacted] | [redacted] |
| Miscellaneous | White Pages | [redacted] | [redacted] | [redacted] |
| | Wholesale | [redacted] | [redacted] | [redacted] |
| | Late Payment Fee | [redacted] | [redacted] | [redacted] |
| | Billing and Collection | [redacted] | [redacted] | [redacted] |
| FCC Nonregulated Revenues (Newly Added) | | [redacted] | | [redacted] |
| **Total Revision to Qwest Adj. PFN-03** | | [redacted] | [redacted] | [redacted] |

Q. Should Qwest's inclusion of new downward adjustments for declining FCC Nonregulated revenue accounts be included within the Company's revenue requirement?

A. No. These are discretionary services offered by Qwest that produce low or negative returns on investment and that have been affirmatively deregulated by the FCC. Mr. Carver sponsors Staff's testimony addressing the treatment of FCC Nonregulated service revenues, expenses and investment in determining intrastate revenue requirements. However, in order to assist the Commission with a full record evidencing Qwest's position on this matter, Staff has included all of the revisions Qwest would make to its Rule 103 filing in Staff Adjustment C-1. Mr. Carver will separately address the Company's proposal to include FCC Nonregulated services as jurisdictional to the ACC.

Q. Turning back to the Local Service revenue category, can you summarize Qwest's original and corrected PFN-03 Adjustment?

A. Yes. In its initial filing, Qwest proposed to reduce annual Local Service revenues by $47.2 million. After correction, the Company's adjustment on a constant-price regression basis is a smaller reduction of $37.8 million. The direction and size of this adjustment is reflective of the ongoing declines in the number of access lines being served by Qwest in Arizona.

Q. Is it appropriate, in your opinion, to recognize sales volumes declines through December 31, 2003 and the related revenue impacts in this proceeding?

A. Yes. These declining volumes of business are a reality of Qwest's business environment at this time. Related downward trends in the size of the Company's work force and in the amount of net Plant in Service invested can be observed and Staff has "cut-off" the measurement of labor costs and rate base as of the same December 31, 2003 date to effect a matching of sales, revenues and costs at a common point in time.[29]

Q. Have you accepted Qwest's revised adjustment to annualize Local Network Services revenues?

A. Yes. The Company's revised adjustments for local recurring and nonrecurring revenues, at lines 3 and 4 of Schedule C-1, appear to produce reasonable results relative to the observed trends in recorded revenues at test period end and should be accepted. Staff proposes no substantive further adjustment in this revenue category after posting the corrections to Qwest's PFN-03 adjustment to restate the prefiled adjustment to a constant price basis, because the end-result of Qwest's revised calculations are reasonable in this revenue category. Staff's acceptance of only the local service portion of the Company's adjustment is not because Qwest's more complex linear regression approach is inherently more precise than alternative methods, but only because the results are reasonable in this instance.

Q. In your prior response, you stated Staff proposed no substantive adjustment to Qwest's revised Local Service Revenues. What is the purpose of Staff Joint Accounting Schedule C-2?

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[29] Staff witness Carver discusses employee headcount trends in his testimony in support of Staff Adjustment C-19 Declining Net Plant investment in Arizona can be observed in the Company's Rule 103 filing at Schedule E-1, Row 3 and in greater detail at Schedule E-5.

A. There is a remaining error Staff is aware of in the Company's revised Local Service Revenue Annualization adjustment and a further Out-of-Period Adjustment to Local Service Revenues that Qwest's filing did not include.

Regarding the regression calculations, an accrual was recorded in November 2002, related to business activity from October 1999 through December 2000, that received a pro-rate treatment across the other months of 2002 in the Company's regression data. Upon inquiry by Staff, the Company responded to Data Requests UTI 6-06 and UTI 12-03 with further information about this entry and an acknowledgment that "The amount should <u>not</u> be prorated since it reflects revenues earned prior to the beginning of the regression period." This issue has been discussed with Qwest and I understand that the Company concurs that this further correction to its updated calculations is appropriate.

Q. Does Staff dispute other elements of the Company's PFN-03 adjustment that pertain to other categories of intrastate revenues?

A. Yes. The revised Qwest PFN-03 adjustment does not reasonably account for end of period revenue levels associated with Intrastate Access Revenues, Intrastate Toll Revenues, Directory Assistance or other Miscellaneous Revenues. These differences are discussed in the following sections of my testimony.

## <u>ACCESS CHARGE REVENUES</u>

Q. Did Qwest prepare an annualization of year-end State Access revenues using the same linear regression methods you described for local service revenues?

A. Yes. Mr. Grate has annualized State Access revenues at year-end using a "Minutes of Use" driver in his regression calculations. After revising his calculations to a "constant price" basis in response to Data Request UTI 2-06, the Company's adjustment serves to increase State Access revenues by $3.1 million or about 3.7 percent.[30] This result is quite different from the Company's prefiled original adjustment PFN-03 that served to reduce State Access revenues by $0.3 million. Correcting for constant price levels was essential to recognize the substantial State

Access rate reductions that have occurred over the last 36 months that created a misleading impression of declining sales trends (if unadjusted dollars are trended) even though actual usage volumes are growing.

Q. Does Staff accept Qwest's revised, constant-dollar State Access revenue annualization in determining the Company's revenue requirement?

A. No. The Company's adjustment does not produce reasonable results, particularly with regard to revenues recorded in Account 5084.31 Private Line Transport Recurring. Qwest's proposed annualized revenue for this specific sub-account is overstated, relative to actual revenue trends at the end of the test period. Staff is proposing an annualized State Access revenue level that is approximately $0.3 million lower than Qwest, based upon the "fourth quarter times four" annualization approach that has been employed in prior rate proceedings for revenue categories that fluctuate based upon usage levels from month to month.

Q. What causes the Company's linear regression methodology to be less reliable for revenues that are usage driven, rather than accounts containing recurring monthly charges?

A. Qwest's proposed linear regression State Access revenue annualization determines a coefficient that represents revenues per minute of use ("MOU"). Then, actual December 2003 actual, recorded MOU are multiplied by the coefficient and added to a constant (Y-intercept) value to yield a normalized December 2003 dollar amount that is multiplied by twelve to annualize. The Company's annualized revenue amount is, therefore, dependent entirely upon how many MOU were recorded in the single month of December 2003. Because State Access MOU usage varies significantly from month to month, the resulting annualized revenue level under Qwest's methodology can be volatile. Staff's alternative approach uses an entire fourth quarter usage and revenue data, which tends to smooth out any usage variability from month to month.

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[30] See Line 6 of Staff Accounting Schedule C-1.

Q. Can you illustrate the variability problem introduced by Qwest's method that employs single-month actual MOU data to calculate the annualized revenue?

A. Yes. Using the State Access MOU information and regression results from a single sub-account where the problem is most acute, the following table compares the annual revenue amount that Qwest's methodology would produce if the data month were shifted to any of the three months prior to December (the month that was actually used by Qwest):

| Data Month | Actual MOU | Coefficient | Intercept | Monthly Amount | Annual Amount |
|---|---|---|---|---|---|
| September | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| October | | | | | |
| November | | | | | |
| Dec. (used) | | | | | |

The impact of fluctuating monthly MOU statistics undermines the ability of Qwest's linear regression method to produce a smoothed indication of annualized revenues. As illustrated in this table, annualized revenues from this single sub-account can vary by as much as $1.9 million depending upon which month's MOU data is used.

Q. How does Staff's approach smooth out monthly fluctuations in observed MOU?

A. Three months of actual revenues are used to capture a larger and more representative data period near test year-end under Staff's approach. Additionally, the effects of shifting usage and revenues from up to 36 months prior to test year end influence the Company's result, while only the most recent and relevant information is considered under the Staff approach.

Q. At page 88 of his testimony, Mr. Grate claims, "Only the regression method eliminates the risk of introducing distortion into the data that can occur when any unidentified anomalies in a single month's financial data are multiplied by twelve. The risk of such anomalies is most pronounced in the month of December, which is the last month of the fiscal year and so subject to year end true-ups and accruals." How do you respond?

A. It is important to identify and correct for financial data anomalies using any methodology that employs such data. Qwest's methodology requires that 36 months worth of data be analyzed and "scrubbed" for unusual transactions. Yet, <u>Qwest has applied its regression coefficient result to a single month's actual statistical data to annualize revenues using a "times twelve" calculation</u>. Thus, Qwest's method suffers from the risk that statistical measures of business volumes, such as access lines, or business orders, or access minutes of use in the month of December are not representative of annual volumes throughout the entire test period. Much of the advantage Mr. Grate claims in avoidance of "unidentified anomalies in a single month's financial data" from his complex regression calculations are diminished by his utilization of a single month's statistical volume data, taken "times twelve" to annualize, without regard to the normalcy of such data.

Q. Are certain types of revenue accounts more stable from month-to-month when looking at statistical measures of business volumes?

A. Yes. Recurring revenues associated with services that are billed monthly, such as basic local service or central office features, because business volumes are large and relatively stable and monthly variations in usage by customers do not impact billings. On the other hand, usage driven accounts, such as access revenues, toll revenues, or directory assistance revenues, can see volumes of business fluctuate significantly from month to month. For these categories, Mr. Grate's approach does little to ensure that December volume statistics are representative of business throughout a full year.

Q. How has Qwest responded to this concern when raised in Staff's discovery?

A. After submitting two data requests (UTI 11-09 and UTI 16-18), Qwest conceded that, "In all instances, the regression coefficient was multiplied by the end of test period value for December 2003", yet the Company would not explain the basis for its assumption that this single month of statistical data is representative and provided no analyses, reports, workpapers or other information relied upon to determine that the

December 2003 unadjusted volume statistic is reasonable to multiply by twelve and by the regression coefficient to annualize revenues.

Q. What is the purpose of Staff Joint Accounting Schedule C-3?

A. This Schedules sets forth the incremental adjustment required to restate Qwest's State Access Revenue annualization adjustment, after correction in Accounting Schedule C-1, to the lower amounts recommended by Staff using the "last quarter times four" approach that has been employed in prior rate cases. In addition, Staff's Access Revenue adjustment reflects a further restatement of Intrastate Access Revenues to reflect the amount of such revenues actually recorded on the Arizona Ledger, reversing an informal ratemaking adjustment Qwest apparently made without documentation based [redacted].[31]

## TOLL SERVICE REVENUES

Q. Has Qwest included Intrastate Toll Revenues in its linear regression-based annualization adjustments?

A. Yes. Using a regression methodology similar to that used for State Access revenues, the Company has adjusted its Intrastate Toll Revenues to an annualized year-end level using either monthly Intrastate Toll Message statistics or Consumer Line counts as the "driver", or independent variable. The overall adjustment proposed by Qwest, after correction to a constant-price basis, would reduce actual test year Intrastate Toll Revenues by $2.3 million. This represents a decline of 21 percent from the average or mid-point of the test year to year-end, which suggests an annualized rate of decline of about 42 percent.

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[31] See Qwest's response to Data Request UTI 13-12, Highly Confidential Attachment A, which appears to [redacted] In its response to UTI 19-02, Qwest argues that GAAP accounting requires it to recognize reduced revenues for "a claim against Qwest [that] satisfies GAAP and Part 32 recognition requirements which the subject of UTI 6-12 (which pertains to Qwest's claims

Q. What is causing the serious downward trend in Intrastate Toll Revenues?

A. The Company's intrastate only long distance service has long been in decline. Information provided in response to Data Request UTI 6-03 indicates that such revenues have declined from more than $90 million annually in 1995 to only $11 million in 2003, a decline of approximately 88 percent. Competitive entry with Equal Access for the interexchange carriers into the IntraLATA toll business in April of 1996 contributed significantly to unfavorable revenue trends in the 1990's as consumers exercised their competitive options with dialing parity. Competition increased post-merger from Qwest LD Corporation (an affiliated reseller) and the recent entry of Qwest Communications Corporation (the facilities based toll affiliate) in December of 2003 can be expected to continue the trend in toll market losses.[32]

Q. Do you dispute Qwest's calculation of annualized IntraLATA Toll revenues?

A. Yes. The Company's adjustment exhibits relatively low R-squared values below .55 for several accounts, barely satisfying Mr. Grate's judgmental screening criteria at the.50 value, below which he would propose no adjustment. Additionally, the overall result of Qwest's annualized IntraLATA Toll revenue adjustment is not consistent with recorded revenue levels in the test period. Specifically, Qwest's proposed annualized monthly revenue level of $[redacted] / 12 months) is lower than every single month of the test period. The lowest recorded test period month IntraLATA Toll revenue was $[redacted] in June of 2003.

Q. How has the Staff calculated annualized IntraLATA Toll revenues?

A. Staff used the same "fourth quarter times four" methodology applied to normalized per books revenues in the last three months of the test year, as was used to revise Qwest's proposed State Access revenue calculations in the prior section of my testimony. This approach has the effect of moderating monthly fluctuations in usage data, while focusing directly on toll market conditions and revenue levels being experienced at the end of the test year. Staff's result is consistent with actual test

against AT&T) does not."

year data and is not dependent upon Mr. Grate's data that is up to 36 months old and subject to relatively poor regression results.

Q. What is the purpose of Staff Joint Accounting Schedule C-4?

A. This Schedule displays the calculations supporting Staff's proposed annualization of IntraLATA Toll revenues, and then compared the result to Qwest's proposed annualized level to yield an incremental adjustment.

## DIRECTORY ASSISTANCE REVENUES

Q. What adjustment is proposed by Qwest to annualize Directory Assistance ("DA") revenues?

A. The Company's revised regression-based adjustment reduces test year DA revenues by more than [redacted],[33] which represents a quite large [redacted] percent reduction in just six months, moving from test year average volumes to year-end annualized volumes. Most of the reduction proposed by Qwest is to annualize declining Residential DA revenues, using the number of residential access lines as the chosen "driver" in the regression analysis.

Q. Does Staff agree that Qwest's DA revenues are experiencing substantial reductions in volumes at the level suggested by Qwest's adjustment?

A. No. There is no question that Directory Assistance volumes and revenues are declining. However, the Company's adjustment fails to produce a reasonable ongoing level, particularly with regard to Residence DA revenues. For Account 5060.32 Directory Assistance Revenue – Residence, the Company's revised pro-forma revenue level is only [redacted] per month, or [redacted] annually. When compared to per books residential DA revenues of [redacted], the Company's adjustment represents a [redacted] percent reduction in only the last 6 months of the test period. However, the lowest actual recorded level of residential DA revenues in any

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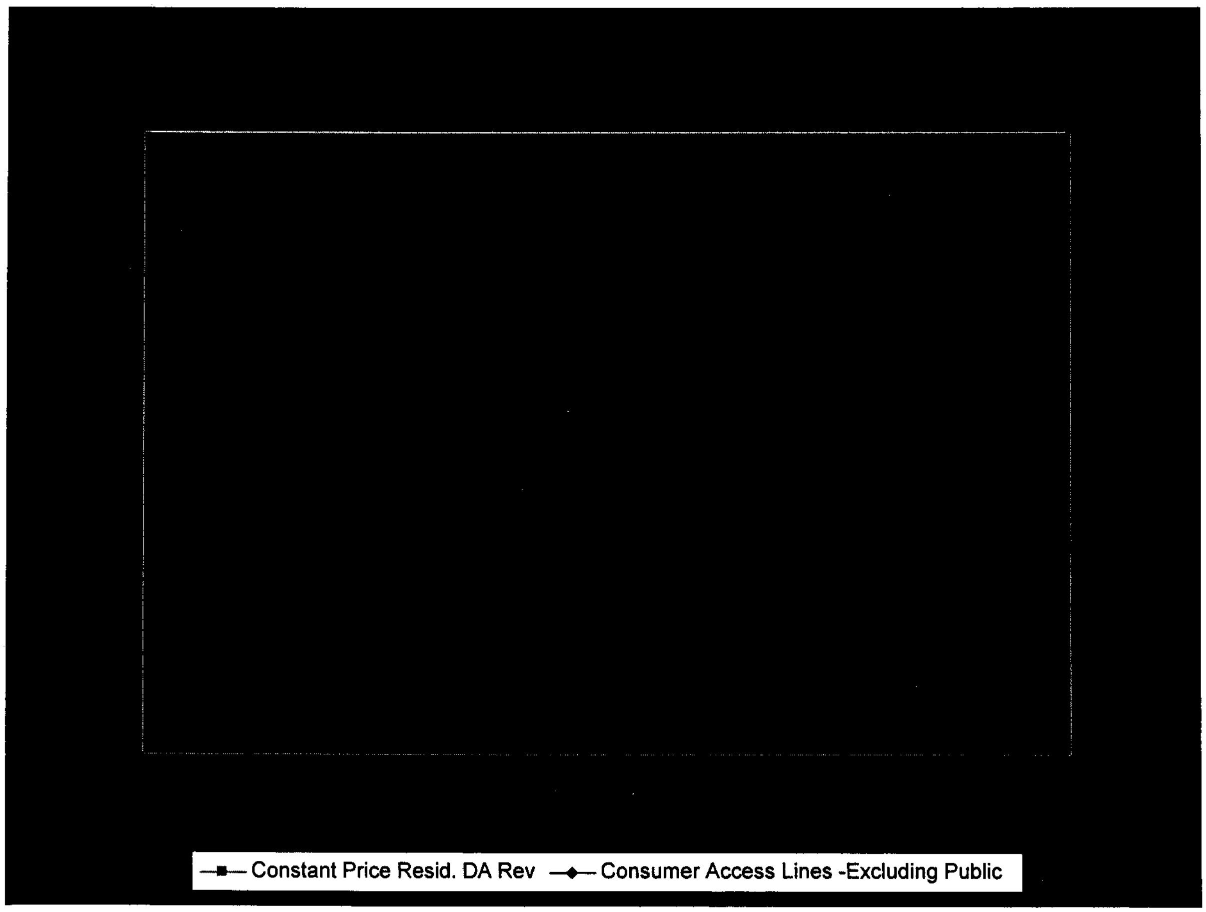
[32] Qwest responses to UTI 13-07 and 15-05.

[33] See Line 5, Column C of Staff Accounting Schedule C-1, where the Company's revised and updated adjustments are summarized.

month of the test year was [redacted] in November 2003. Thus, the Company's adjustment result is not credible in relation to any actual data in the test year and should be rejected.

Q. Is there a reason why the Company's revised, constant-price linear regression approach may produce unrealistic results for the Directory Assistance revenue accounts?

A. Yes. Qwest has implemented quite large price increases for DA services in April of 2001 and again in April of 2002, with much smaller price increases again in April of 2003. The rate of decline in monthly DA volumes and constant price revenues was much steeper in the months prior to 2003 than during the test period. It is possible that the demands of more price sensitive customers were driven down by the large price increases in the early portion of Qwest's 36-month regression period, while volumes and revenues have stabilized along with pricing in 2003. With the 36 month regression period used by Qwest, early periods of rapid decline may be unreasonably extrapolated into the 2003 test year and serve to understate year-end volumes and revenues. The following confidential chart illustrates the trends in constant price Residential Directory Assistance Revenues during the 36 month analysis period employed by Qwest:




This chart illustrates the reduced rate of decline in Residential DA revenues being experienced after 2002 and also clearly shows how unreasonable the Company's proposed annualized level of [redacted] per month is, relative to all months of the test year.

Q. You have not included a comparable graph for the Business Directory Assistance ("DA") monthly revenue in Account 5060.31. Is there any reason why your discussion focuses solely upon the Residential DA revenues?

A. Yes. Most of the difference in results between the Qwest and Staff methodologies can be traced to the Residential portion of DA revenues. Another graph of the Business DA revenues would exhibit a downward trend comparable to the graph of Residential DA data presented above. However, both the Staff and Company-proposed annualized revenue levels would be consistent with the recorded revenue data in the last few months of the graph. I did not include this second graph because most of the difference at issue is within the Residential DA revenue sub-accounts.

Q. What is the purpose of Staff Joint Accounting Schedule C-5?

A. This Schedule sets forth certain revisions to Qwest's revised constant-price DA revenue annualization, so as to produce more representative ongoing levels of such revenues. As with other types of revenues where demand tends to fluctuate based upon month-to-month variations in usage levels, the Staff's proposed adjustment is based upon the last quarter 2003 normalized revenues in each account, multiplied times four to annualize.

Q. Did Staff submit a data request to Qwest asking the Company to explain its apparently excessive reduction in Residence Directory Assistance Revenues?

A. Yes. In its response to Data Request UTI 12-012, the Company did not attempt to defend the reasonableness of its adjustment to this account, instead stating, "When this particular adjustment is viewed in isolation, there is no question that the amount of the normalizing adjustment exceeds the actual revenue decline the Company has experienced in Account 5060.32 since the close of the test period." Then, as part of its further explanation, the Company referenced another account (Local Recurring Revenue Account 5001.21) where Qwest's adjustment result understated the rate of revenue decline, when evaluated relative to actual revenue changes through August of 2004. However, Staff does not believe the test period should be revised through August 2004 and has not tested or compared revenues, expenses or rate base past test year-end. The purpose of the revenue annualization adjustments is to reasonably quantify ongoing, annual revenues as of the end of the 2003 test period.

## FAIR VALUE RATE BASE

Q. What is proposed by Qwest with respect to fair value rate base?

A. The Company has employed a 50/50 weighting of an original cost valuation and a reproduction cost new, less depreciation ("RCNLD") valuation of its Arizona

Telecommunications Plant in Service to define fair value rate base. Qwest witness Ms. Heller-Hughes sponsors the RCNLD study and valuation evidence, with results incorporated into Qwest's R14-2-103 filing at Schedule B-4. RCNLD and original cost net plant values are weighted together using the 50/50 approach at Schedule B-3 of the filing. The Company's rate base adjustments are posted directly to the original cost rate base, and are factored up by a ratio reflective of 50/50 weighting of original cost and RCND net plant values for posting to the asserted fair value rate base.

Q. Has Qwest proposed application of a reasonable fair rate of return to its fair value rate base?

A. No. Schedule A-1 of the Company's R14-2-103 filing shows Qwest attributing the same weighted average cost of capital to both its original cost rate base as well as its fair value rate base. This is clearly inappropriate, in that the fair value rate base accounts for the effects of inflation upon the historical cost of plant that was installed in prior years. A fair rate of return applicable to plant investment that has been factored up for inflation would be a return rate that has been "stripped" of the inflation component of the return. Otherwise investors are compensated twice for the effects of inflation upon their invested capital – once through the inflation component embedded in debt interest rates and the equity return; and again through inflation adjustment of the principal amount of their past investments. This double counting produces an overstated revenue requirement, that in Qwest's initial filing increased the $322 million amount discussed in testimony to more than $441 million, as shown at line 10 of Qwest schedule A-1.

Q. Has the Company offered any support in testimony for a fair rate of return on fair value investment equal to its cost of capital, as shown at line 5 of Schedule A-1?

A. No. Mr. Cummings testimony addresses the Company's cost of capital that is applicable to its original cost investment. His testimony supports a return on equity capital of 21.4 percent, which is included in the Company's asserted overall cost of capital at Schedule D-1 of Qwest's filing. However, if the same overall cost of capital is applied to the higher fair value rate base, the resulting income available for book common equity would produce a Return on Equity as high as 41 percent, a result clearly inconsistent with the evidence in this Docket.

Q. How has Staff determined the required rate of return on fair value rate base, for purposes of quantifying Qwest's Arizona intrastate revenue requirement?

A. Staff Joint Accounting Schedule A sets forth a fair rate of return on fair value rate base that will provide Qwest the opportunity to earn income sufficient to meet its overall cost of capital, as sponsored by Staff witness Reiker. To the extent the valuation of rate base is increased to account for estimated fair value, a corresponding reduction in the required rate of return is necessary to recognize that the income required to meet investors' requirements does not change when property valuation approaches are changed. Said differently, Qwest creditors and shareholders don't require more interest income, net income or cash flow in fair value jurisdictions like Arizona, than they require in other states. The business income and cash flow required to attract capital on reasonable terms is the same, irrespective of the basis of property valuation. No bonus income is required or warranted by the Company as a result of its fair value.

Q. Are there differences in the RCNLD value used to determine fair value rate base in the Staff's filing, in comparison to Qwest's RCNLD study?

A. Yes. Staff witness William Dunkel sponsors certain adjustments to the Percent Condition factors used in Qwest's Reproduction Cost New, Less Depreciation study that are explained in his testimony. The adjustments sponsored by Mr. Dunkel in his Schedule WDA-17 and are incorporated into Staff Joint Accounting Schedule A-2 as a revision to Qwest's asserted RCND values. It is necessary to apply a fifty percent weighting to the difference in percent condition proposed by Staff, due to Qwest's 50/50 weighting of the Reproduction Cost New Less Depreciation and the Original Cost rate base amounts to derive Fair Value Rate Base.

## UNCOLLECTIBLE REVENUE CONVERSION FACTOR

Q. Please explain the purpose of the Revenue Conversion Factor and how it is employed in determining revenue requirements.

A. The revenue conversion factor is used to translate operating income values that are quantified on an after-tax basis into the equivalent amount of pre-tax revenue that is required to produce the required income effect. For example, application of the rate of return to Qwest's rate base tells us how much operating income is required to meet capital costs for the business. To produce an incremental dollar of after-tax income for this purpose, whenever rate base or rate of return increases, it is actually necessary to increase revenues by significantly more because each dollar of new revenue is subject to incremental tax and uncollectible revenue costs. The "Revenue Conversion Factor" developed on Staff Joint Accounting Schedule A-1 sets forth how this factor is developed by Qwest and by Staff. There are two differences revealed in comparing columns C versus D of Schedule A-1. First, the "Uncollectible Revenue" percentage on line 2 is different, for reasons I will discuss in testimony. The second difference relates to income tax rates, which are discussed by Mr. Carver.

Q. Why is the Staff's uncollectible percentage lower than has been proposed by Qwest in the Revenue Conversion Factor?

A. The Qwest uncollectible percentage is based upon unadjusted, test year actual uncollectible expense levels, divided by certain test year revenue accounts, as shown in the first portion of the "Footnote b" calculations at the bottom of Schedule A-1. However, Qwest made an adjustment elsewhere in its filing to recognize that test year actual uncollectible expenses were unusually high and should be normalized, as part of Mr. Grate's revenue annualization regression calculations.[34] It is necessary to incorporate this Company-proposed adjustment into the Revenue Conversion Factor to accomplish the same normalization of uncollectibles throughout the determination of revenue requirements. If uncollectible expense levels were unreasonable for one

34 Qwest's Uncollectible Adjustment is part of Adjustment PFN-03.

purpose, they are unreasonable for all purposes. Staff has included the Company's uncollectible adjustment within the Revenue Conversion Factor to achieve internal consistency with the adjusted income statement.

Q. Does this conclude your testimony at this time?

A. Yes.

# MICHAEL L. BROSCH

## Summary of Qualifications

| | |
|---|---|
| EMPLOYER: | Utilitech, Inc.<br>Regulatory and Management Consultants |
| POSITION: | President |
| ADDRESS: | 740 NW Blue Parkway, Suite 204<br>Lee's Summit, Missouri 64086 |

PRIOR EXPERIENCE:

| | |
|---|---|
| 1978-1982 | Missouri Public Service Commission, Senior Accountant |
| 1982-1983 | Troupe, Kehoe, Whiteaker & Kent CPA's, Regulatory Consultant |
| 1983-1985 | Lubow, McKay, Stevens and Lewis, Project Manager |
| 1985-Present | Utilitech, Principal and President |

DEGREES:
University of Missouri – Kansas City
Bachelor – Business Administration (Accounting 1978) "with distinction"

OTHER QUALIFICATIONS:

Certified Public Accountant – Certification in Kansas and Missouri

| | |
|---|---|
| Member | American Institute of Certified Public Accountants<br>Missouri Society of Certified Public Accountants<br>Kansas Society of Certified Public Accountants<br>Beta Alpha Psi, professional accounting scholastic fraternity |
| Seminars | Iowa State Regulatory Conference 1981, 1985<br>Regulated Industries Symposium 1979, 1980<br>Michigan State Regulatory Conference 1981<br>United States Telephone Association Round Table 1984<br>NARUC/NASUCA Annual Meeting 1988, Speaker<br>NARUC/NASUCA Annual Meeting 2000, Speaker |
| Instructor | INFOCAST Ratemaking Courses<br>Arizona Staff Training<br>Hawaii Staff Training |

PRIOR TESTIMONIES: (See listings attached)

**Michael L. Brosch**
Utilitech, Inc. – President
Bachelor of Business Administration (Accounting)
University of Missouri-Kansas City (1978)
Certified Public Accountant Examination (1979)

**GENERAL**

Mr. Brosch serves as the director of regulatory projects for the firm and is responsible for the planning, supervision and conduct of firm engagements. His academic background is in business administration and accounting and he holds CPA certificates in Kansas and Missouri.

**EXPERIENCE**

Mr. Brosch has supervised and conducted the preparation of rate case exhibits and testimony in support of revenue requirements of electric, gas, telephone, water, and sewer utilities in response to tariff change proposals as a consultant and while employed by the Missouri Commission Staff. Responsible for virtually all facets of revenue requirement determination cost of service allocations and tariff implementation in addition to involvement in numerous special project investigations.

Industry restructuring analysis for gas utility rate unbundling, deregulation, competitive bidding and strategic planning, with testimony on regulatory processes, asset identification and classification, revenue requirement and unbundled rate designs and class cost of service studies.

Responsible for analysis and presentation of income tax related issues within ratemaking proceedings involving interpretation of relevant IRS code provisions and regulatory restrictions.

Conducted extensive review of the economic impact upon regulated utility companies of various transactions involving affiliated companies. Reviewed the parent-subsidiary relationships of integrated utility holding companies to determine appropriate treatment of consolidated tax benefits and capital costs. Sponsored testimony on affiliated interests in numerous Bell and major independent telephone company rate proceedings.

Has substantial experience in the application of lead-lag study concepts and methodologies in determination of working capital investment to be included in rate base.

Alternative regulation analyses and consultation to clients in Arizona, California and Oklahoma, focused upon challenges introduced by cost-based regulation, incentive effects available through alternative regulation and balancing of risks, opportunities and benefits among stakeholders.

Mr. Brosch managed the detailed regulatory review of utility mergers and acquisitions, diversification studies and holding company formation issues in energy and telecommunications transactions in multiple states. Sponsored testimony regarding merger synergies, merger accounting and tax implications, regulatory planning and price path strategies. Traditional horizontal utility mergers as well as leveraged buyouts of utility properties by private equity investors were addressed in several states.

Analyzed the regulation of telephone company publishing affiliates, including the propriety of continued imputation of directory publishing profits and the valuation of publishing affiliates, including the identification and quantification of intangible assets and benefits of affiliation with the regulated business in Arizona, Indiana, Washington and Utah.

## WORK HISTORY

| | |
|---|---|
| 1985 - Present | **Principal** - Utilitech, Inc. (Previously Dittmer, Brosch and Associates, Inc.) |
| 1983 - 1985: | **Project manager** - Lubow McKay Stevens and Lewis. Responsible for supervision and conduct of utility regulatory projects on behalf of industry and regulatory agency clients. |
| 1982 - 1983: | **Regulatory consultant** - Troupe Kehoe Whiteaker and Kent. Responsible for management of rate case activities involving analysis of utility operations and results, preparation of expert testimony and exhibits, and issue development including research and legal briefs. Also involved in numerous special projects including financial analysis and utility systems planning. Taught firm's professional education course on "utility income taxation - ratemaking and accounting considerations" in 1982. |
| 1978 - 1982: | **Senior Regulatory Accountant** - Missouri Public Service Commission. Supervised and conducted rate case investigations of utilities subject to PSC jurisdiction in response to applications for tariff changes. Responsibilities included development of staff policy on ratemaking issues, planning and evaluating work of outside consultants, and the production of comprehensive testimony and exhibits in support of rate case positions taken. |

## OTHER QUALIFICATIONS

Bachelor of Business Administration - Accounting, 1978
University of Missouri - Kansas City "with distinction"

| | |
|---|---|
| Member | American Institute of Certified Public Accountants<br>Missouri Society of Certified Public Accountants<br>Beta Alpha Psi, professional accounting scholastic fraternity<br>Kansas Society of Certified Public Accountants |
| Attended | Iowa State Regulatory Conference 1981, 1985<br>Regulated Industries Symposium 1979, 1980<br>Michigan State Regulatory Conference 1981<br>United States Telephone Association Round Table 1984<br>NARUC/NASUCA Annual Meeting 1988, Speaker<br>NARUC/NASUCA Annual Meeting 2000, Speaker |
| Instructor | INFOCAST Ratemaking Courses<br>Arizona Staff Training<br>Hawaii Staff Training |

# Michael L. Brosch
## Summary of Previously Filed Testimony
## 1981 through 2003

| Utility | Jurisdiction | Agency | Docket/Case Number | Represented | Year | Addressed |
|---|---|---|---|---|---|---|
| Kansas City Power and Light Co. | Missouri | PSC | ER-81-42 | Staff | 1981 | Rate Base, Operating Income |
| Southwestern Bell Telephone | Missouri | PSC | TR-81-208 | Staff | 1981 | Rate Base, Operating Income, Affiliated Interest |
| Northern Indiana Public Service | Indiana | PSC | 36689 | Consumers Counsel | 1982 | Rate Base, Operating Income |
| Northern Indiana Public Service | Indiana | URC | 37023 | Consumers Counsel | 1983 | Rate Base, Operating Income, Cost Allocations |
| Mountain Bell Telephone | Arizona | ACC | 9981-E1051-81-406 | Staff | 1982 | Affiliated Interest |
| Sun City Water | Arizona | ACC | U-1656-81-332 | Staff | 1982 | Rate Base, Operating Income |
| Sun City Sewer | Arizona | ACC | U-1656-81-331 | Staff | 1982 | Rate Base, Operating Income |
| El Paso Water | Kansas | City Counsel | Unknown | Company | 1982 | Rate Base, Operating Income, Rate of Return |
| Ohio Power Company | Ohio | PUCO | 83-98-EL-AIR | Consumer Counsel | 1983 | Operating Income, Rate Design, Cost Allocations |
| Dayton Power & Light Company | Ohio | PUCO | 83-777-GA-AIR | Consumer Counsel | 1983 | Rate Base |
| Walnut Hill Telephone | Arkansas | PSC | 83-010-U | Company | 1983 | Operating Income, Rate Base |
| Cleveland Electric Illum. | Ohio | PUCO | 84-188-EL-AIR | Consumer Counsel | 1984 | Rate Base, Operating Income, Cost Allocations |
| Cincinnati Gas & Electric | Ohio | PUCO | 84-13-EL-EFC | Consumer Counsel | 1984 | Fuel Clause |
| Cincinnati Gas & Electric | Ohio | PUCO | 84-13-EL-EFC (Subfile A) | Consumer Counsel | 1984 | Fuel Clause |
| General Telephone - Ohio | Ohio | PUCO | 84-1026-TP-AIR | Consumer Counsel | 1984 | Rate Base |
| Cincinnati Bell Telephone | Ohio | PUCO | 84-1272-TP-AIR | Consumer Counsel | 1985 | Rate Base |
| Ohio Bell Telephone | Ohio | PUCO | 84-1535-TP-AIR | Consumer Counsel | 1985 | Rate Base |
| United Telephone - Missouri | Missouri | PSC | TR-85-179 | Staff | 1985 | Rate Base, Operating Income |
| Wisconsin Gas | Wisconsin | PSC | 05-UI-18 | Staff | 1985 | Diversification-Restructuring |
| United Telephone - Indiana | Indiana | URC | 37927 | Consumer Counsel | 1986 | Rate Base, Affiliated Interest |
| Indianapolis Power & Light | Indiana | URC | 37837 | Consumer Counsel | 1986 | Rate Base |
| Northern Indiana Public Service | Indiana | URC | 37972 | Consumer Counsel | 1986 | Plant Cancellation Costs |
| Northern Indiana Public Service | Indiana | URC | 38045 | Consumer Counsel | 1986 | Rate Base, Operating Income, Cost Allocations, Capital Costs |
| Arizona Public Service | Arizona | ACC | U-1435-85-367 | Staff | 1987 | Rate Base, Operating Income, Cost Allocations |
| Kansas City, KS Board of Public Utilities | Kansas | BPU | 87-1 | Municipal Utility | 1987 | Operating Income, Capital Costs |
| Detroit Edison | Michigan | PSC | U-8683 | Industrial Customers | 1987 | Income Taxes |

# Michael L. Brosch
## Summary of Previously Filed Testimony
## 1981 through 2003

| | | | | | | |
|---|---|---|---|---|---|---|
| Consumers Power | Michigan | PSC | U-8681 | Industrial Customers | 1987 | Income Taxes |
| Consumers Power | Michigan | PSC | U-8680 | Industrial Customers | 1987 | Income Taxes |
| Northern Indiana Public Service | Indiana | URC | 38365 | Consumer Counsel | 1987 | Rate Design |
| Indiana Gas | Indiana | URC | 38080 | Consumer Counsel | 1987 | Rate Base |
| Northern Indiana Public Service | Indiana | URC | 38380 | Consumers Counsel | 1988 | Rate Base, Operating Income, Rate Design, Capital Costs |
| Terre Haute Gas | Indiana | URC | 38515 | Consumers Counsel | 1988 | Rate Base, Operating Income, Capital Costs |
| United Telephone -Kansas | Kansas | KCC | 162,044-U | Consumers Counsel | 1989 | Rate Base, Capital Costs, Affiliated Interest |
| US West Communications | Arizona | ACC | E-1051-88-146 | Staff | 1989 | Rate Base, Operating Income, Affiliate Interest |
| All Kansas Electrics | Kansas | KCC | 140,718-U | Consumers Counsel | 1989 | Generic Fuel Adjustment Hearing |
| Southwest Gas | Arizona | ACC | E-1551-89-102 E-1551-89-103 | Staff | 1989 | Rate Base, Operating Income, Affiliated Interest |
| American Telephone and Telegraph | Kansas | KCC | 167,493-U | Consumers Counsel | 1990 | Price/Flexible Regulation, Competition, Revenue Requirements |
| Indiana Michigan Power | Indiana | URC | 38728 | Consumer Counsel | 1989 | Rate Base, Operating Income, Rate Design |
| People Gas, Light and Coke Company | Illinois | ICC | 90-0007 | Public Counsel | 1990 | Rate Base, Operating Income |
| United Telephone Company | Florida | PSC | 891239-TL | Public Counsel | 1990 | Affiliated Interest |
| Southwestern Bell Telephone Company | Oklahoma | OCC | PUD-000662 | Attorney General | 1990 | Rate Base, Operating Income (Testimony not admitted) |
| Arizona Public Service Company | Arizona | ACC | U-1345-90-007 | Staff | 1991 | Rate Base, Operating Income |
| Indiana Bell Telephone Company | Indiana | URC | 39017 | Consumer Counsel | 1991 | Test Year, Discovery, Schedule |
| Southwestern Bell Telephone Company | Oklahoma | OCC | 39321 | Attorney General | 1991 | Remand Issues |
| UtiliCorp United/ Centel | Kansas | KCC | 175,476-U | Consumer Counsel | 1991 | Merger/Acquisition |
| Southwestern Bell Telephone Company | Oklahoma | OCC | PUD-000662 | Attorney General | 1991 | Rate Base, Operating Income |
| United Telephone - Florida | Florida | PSC | 910980-TL | Public Counsel | 1992 | Affiliated Interest |
| Hawaii Electric Light Company | Hawaii | PUC | 6999 | Consumer Advocate | 1992 | Rate Base, Operating Income, Budgets/Forecasts |
| Maui Electric Company | Hawaii | PUC | 7000 | Consumer Advocate | 1992 | Rate Base, Operating Income, Budgets/Forecasts |
| Southern Bell Telephone Company | Florida | PSC | 920260-TL | Public Counsel | 1992 | Affiliated Interest |
| US West Communications | Washington | WUTC | U-89-3245-P | Attorney General | 1992 | Alternative Regulation |
| UtiliCorp United/ MPS | Missouri | PSC | ER-93-37 | Staff | 1993 | Affiliated Interest |
| Oklahoma Natural Gas Company | Oklahoma | OCC | PUD-1151, 1144, 1190 | Attorney General | 1993 | Rate Base, Operating Income, Take or Pay, Rate Design |

Michael L. Brosch
Summary of Previously Filed Testimony
1981 through 2003

| | | | | | | |
|---|---|---|---|---|---|---|
| Public Service Company of Oklahoma | Oklahoma | OCC | PUD-1342 | Staff | 1993 | Rate Base, Operating Income, Affiliated Interest |
| Illinois Bell Telephone | Illinois | ICC | 92-0448<br>92-0239 | Citizens Board | 1993 | Rate Base, Operating Income, Alt. Regulation, Forecasts, Affiliated Interest |
| Hawaii Electric Company | Hawaii | PUC | 7700 | Consumer Advocate | 1993 | Rate Base, Operating Income |
| US West Communications | Arizona | ACC | E-1051-93-183 | Staff | 1994 | Rate Base, Operating Income |
| PSI Energy, Inc. | Indiana | URC | 39584 | Consumer Counselor | 1994 | Rate Base, Operating Income, Alt. Regulation, Forecasts, Affiliated Interest |
| Arkla, a Division of NORAM Energy | Oklahoma | OCC | PUD-940000354 | Attorney General | 1994 | Cost Allocations, Rate Design |
| PSI Energy, Inc. | Indiana | URC | 39584-S2 | Consumer Counselor | 1994 | Merger Costs and Cost Savings, Non-Traditional Ratemaking |
| Transok, Inc. | Oklahoma | OCC | PUD-1342 | Staff | 1994 | Rate Base, Operating Income, Affiliated Interest, Allocations |
| Oklahoma Natural Gas Company | Oklahoma | OCC | PUD-940000477 | Attorney General | 1995 | Rate Base, Operating Income, Cost of Service, Rate Design |
| US West Communications | Washington | WUTC | UT-950200 | Attorney General/ TRACER | 1995 | Operating Income, Affiliate Interest, Service Quality |
| PSI Energy, Inc. | Indiana | URC | 40003 | Consumer Counselor | 1995 | Rate Base, Operating Income |
| Oklahoma Natural Gas Company | Oklahoma | OCC | PUD-880000598 | Attorney General | 1995 | Stand-by Tariff |
| GTE Hawaiian Telephone Co., Inc. | Hawaii | PUC | PUC 94-0298 | Consumer Advocate | 1996 | Rate Base, Operating Income, Affiliate Interest, Cost Allocations |
| Mid-American Energy Company | Iowa | ICC | APP-96-1 | Consumer Advocate | 1996 | Non-Traditional Ratemaking |
| Oklahoma Gas and Electric Company | Oklahoma | OCC | PUD-960000116 | Attorney General | 1996 | Rate Base, Operating Income, Rate Design, Non-Traditional Ratemaking |
| Southwest Gas Corporation | Arizona | ACC | U-1551-96-596 | Staff | 1997 | Operating Income, Affiliated Interest, Gas Supply |
| Utilicorp United - Missouri Public Service Division | Missouri | PSC | EO-97-144 | Staff | 1997 | Operating Income |
| US West Communications | Utah | PSC | 97-049-08 | Consumer Advocate | 1997 | Rate Base, Operating Income, Affiliate Interest, Cost Allocations |
| US West Communications | Washington | WUTC | UT-970766 | Attorney General | 1997 | Rate Base, Operating Income |
| Missouri Gas Energy | Missouri | PSC | GR 98-140 | Public Counsel | 1998 | Affiliated Interest |
| ONEOK | Oklahoma | OCC | PUD980000177 | Attorney General | 1998 | Gas Restructuring, rate Design, Unbundling |
| Nevada Power/Sierra Pacific Power Merger | Nevada | PSC | 98-7023 | Consumer Advocate | 1998 | Merger Savings, Rate Plan and Accounting |
| PacifiCorp / Utah Power | Utah | PSC | 97-035-1 | Consumer Advocate | 1998 | Affiliated Interest |

Michael L. Brosch
Summary of Previously Filed Testimony
1981 through 2003

| | | | | | | |
|---|---|---|---|---|---|---|
| MidAmerican Energy / CalEnergy Merger | Iowa | PUB | SPU-98-8 | Consumer Advocate | 1998 | Merger Savings, Rate Plan and Accounting |
| American Electric Power / Central and South West Merger | Oklahoma | OCC | 980000444 | Attorney General | 1998 | Merger Savings, Rate Plan and Accounting |
| ONEOK Gas Transportation | Oklahoma | OCC | 970000088 | Attorney General | 1998 | Cost of Service, Rate Design, Special Contract |
| U S West Communications | Washington | WUTC | UT-98048 | Attorney General | 1999 | Directory Imputation and Business Valuation |
| U S West / Qwest Merger | Iowa | PUB | SPU 99-27 | Consumer Advocate | 1999 | Merger Impacts, Service Quality and Accounting |
| U S West / Qwest Merger | Washington | WUTC | UT-991358 | Attorney General | 2000 | Merger Impacts, Service Quality and Accounting |
| U S West / Qwest Merger | Utah | PSC | 99-049-41 | Consumer Advocate | 2000 | Merger Impacts, Service Quality and Accounting |
| PacifiCorp / Utah Power | Utah | PSC | 99-035-10 | Consumer Advocate | 2000 | Affiliated Interest |
| Oklahoma Natural Gas, ONEOK Gas Transportation | Oklahoma | OCC | 980000683, 980000570, 990000166 | Attorney General | 2000 | Operating Income, Rate Base, Cost of Service, Rate Design, Special Contract |
| U S West Communications | New Mexico | PRC | 3008 | Staff | 2000 | Operating Income, Directory Imputation |
| U S West Communications | Arizona | ACC | T-0105B-99-0105 | Staff | 2000 | Operating Income, Rate Base, Directory Imputation |
| Northern Indiana Public Service Company | Indiana | IURC | 41746 | Consumer Counsel | 2001 | Operating Income, Rate Base, Affiliate Transactions |
| Nevada Power Company | Nevada | PUCN | 01-10001 | Attorney General-BCP | 2001 | Operating Income, Rate Base, Merger Costs, Affiliates |
| Sierra Pacific Power Company | Nevada | PUCN | 01-11030 | Attorney General-BCP | 2002 | Operating Income, Rate Base, Merger Costs, Affiliates |
| The Gas Company, Division of Citizens Communications | Hawaii | PUC | 00-0309 | Consumer Advocate | 2001 | Operating Income, Rate Base, Cost of Service, Rate Design |
| SBC Pacific Bell | California | PUC | I.01-09-002 R.01-09-001 | Office of Ratepayer Advocate | 2002 | Depreciation, Income Taxes and Affiliates |
| Midwest Energy, Inc. | Kansas | KCC | 02-MDWG-922-RTS | Agriculture Customers | 2002 | Rate Design, Cost of Capital |
| Qwest Communications – Dex Sale | Utah | PSC | 02-049-76 | Consumer Advocate | 2003 | Directory Publishing |
| Qwest Communications – Dex Sale | Washington | WUTC | UT-021120 | Attorney General | 2003 | Directory Publishing |
| Qwest Communications – Dex Sale | Arizona | ACC | T-0105B-02-0666 | Staff | 2003 | Directory Publishing |
| PSI Energy, Inc. | Indiana | IURC | 42359 | Consumer Counsel | 2003 | Operating Income, Rate Trackers, Cost of Service, Rate Design |

Arizona
T-01051B-03-0454
UTI 01-012S1

INTERVENOR: Utilitech, Inc.

REQUEST NO: 012S1

According to the testimony of Mr. Philip Grate at page 131, the Company has not adjusted its actual 2003 incurred costs for image advertising. Please provide a summary of all advertising costs by campaign/message, by cost type (previously EXTC), by responsibility center (RC) and by FCC Account for the test year and provide representative copies of advertising script/copy indicative of the content of advertisements within each campaign or category, indicating those which would be considered non-product specific or "image" advertising.

RESPONSE:

Qwest is in the process of gathering this information and will provide it as soon as it is available.

Respondent: Michael Hudson, Qwest Manager

**SUPPLEMENTAL RESPONSE DATED 06/25/04:**

See Attachments A and A-2 which contain all 2003 printed corporate advertisements.

See Attachment B containing all 2003 TV corporate advertisements.

See Confidential Attachment C for Arizona corporate advertising costs account 6722.2 by RC and EXTC.

The corporate advertising costs are not tracked by campaign/message.

Respondent: Janet Ortega

# "EN EL CENTRO DE QWEST, USTED NOS HABLA Y NOSOTROS LE RESPONDEMOS EN SU IDIOMA."

—Deanna, Representante de Ventas de Qwest

**ESE ES EL CENTRO DE QWEST, UN LUGAR DONDE LE HABLAMOS EN ESPAÑOL.**

Allí nos puede llamar al **1 800-564-1121** y preguntarnos por planes telefónicos, ofertas, mantenimiento, instalaciones, facturas y en todo lo que le podamos ayudar.

Si está interesado en ser parte de uno de los equipos bilingües de Qwest,® visítenos en nuestro sitio de Internet: www.qwest.com/careers

Qwest.
*Espíritu de Servicio™*

EL CENTRO DE QWEST, DONDE LE BRINDAMOS ATENCION EN SU IDIOMA.™

© 2003 Qwest Communications Inter

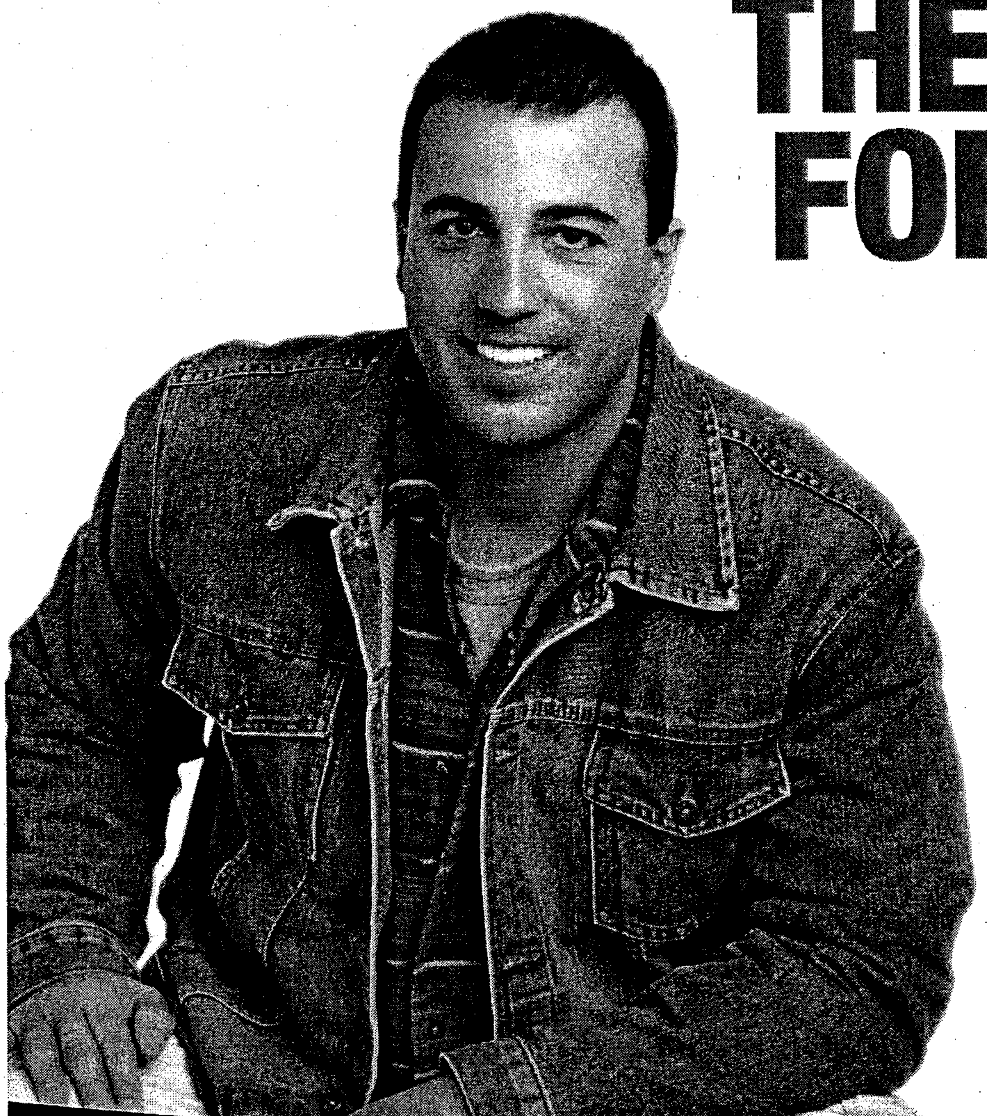
ARIZONA
Docket No. 01051B-03-0454
UTI 1-12
Attachment A



© 2003 Qwest Communications International Inc.

# “DAY. NI
# WEEKDAYS.
# WEEKENDS.
# NOW IT'S ALL THE SAME FOR YOU.”

—Justin, Qwest Sr. Sales Consultant



**A 24-HOUR CUSTOMER SELF-HELP LINE AND NOW INTRODUCING EXTENDED HOME SERVICE HOURS FROM QWEST.®**

7 a.m.–9 p.m. weekdays • 8 a.m.–4:30 p.m. Saturdays • 24/7 self-help lines • Speak to a live repair representative 24/7

**FOR CUSTOMER SERVICE CALL 1 800-244-1111**

Qwest
*Spirit of Service™*

MAKING IT EASIER FOR YOU TO DO BUSINESS WITH US. VISIT QWEST.COM

# "YOU. YOU. YOU. IT'S ALL ABOUT YOU. MYQWEST.COM."

—Laurence, Qwest Software Engineer

NOW INTRODUCING THE NEW MYQWEST.COM. CUSTOMIZE IT TO BE YOURS.

Manage your account • Check your wireless minutes • Request repairs • Pay bills • Information on products and plans

Qwest.
Spirit of Service™

MAKING IT EASIER FOR YOU TO DO BUSINESS WITH US. VISIT MYQWEST.COM TO REGISTER

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# "CUSTOMER SERVICE THAT REALLY SERVES CUSTOMERS."

—Jim, Qwest Network Technician


## NOW, HERE'S THE ACTION BEHIND THE WORDS:

We stay open on Saturdays and later on weekdays for home service, and we have live repair representatives available 24/7

We have a newly designed Web site, MyQwest.com, which you can customize to manage your account

We will give you a reminder call before every service visit and contact you after we're done, to make sure you're satisfied

We bring you simplicity and savings on local phone, wireless and high-speed Internet service, all on one bill with just one number to call

And we have more service improvements on the way

Qwest.
*Spirit of Service™*

MAKING IT EASIER FOR YOU TO DO BUSINESS WITH US. VISIT QWEST.COM

ARIZONA
DOCKET NO. T-01051B-03-0454
UTI 01-12
ATTACHMENT A

Attachment MLB-3
Page 6 of 11

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# “CUSTO[illegible] SERVICE THAT REALLY SERVES CUSTOMERS.”

—Myrtha, Qwest Sales / Service Consultant

## NOW, HERE'S THE ACTION BEHIND THE WORDS:

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Qwest
Spirit of Service™

MAKING IT EASIER FOR YOU TO DO BUSINESS WITH US. VISIT QWEST.COM

ARIZONA
Docket No. 01051B-03-0454
UTI 1-12
Attachment A



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# “DAY. NI
# WEEKDAYS. WEEKENDS. NOW IT'S ALL THE SAME FOR YOU.”

—Alexandra, Qwest Sales Consultant

A 24-HOUR CUSTOMER SELF-HELP LINE AND NOW INTRODUCING EXTENDED HOME SERVICE HOURS FROM QWEST.®

7 a.m.–9 p.m. weekdays • 8 a.m.–4:30 p.m. Saturdays • 24/7 self-help lines • Speak to a live repair representative 24/7

Qwest.
*Spirit of Service™*

MAKING IT EASIER FOR YOU TO DO BUSINESS WITH US. VISIT QWEST.COM

# "YOU. YOU. YOU. IT'S ALL ABOUT YOU. MYQWEST.COM."

—Laurence, Qwest Software Engineer

NOW INTRODUCING THE NEW MYQWEST.COM. CUSTOMIZE IT TO BE YOURS.

Manage your account • Check your wireless minutes • Request repairs • Pay bills • Information on products and plans

Qwest.
Spirit of Service™

MAKING IT EASIER FOR YOU TO DO BUSINESS WITH US. VISIT MYQWEST.COM TO REGISTER

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# "CUSTOMER SERVICE THAT REALLY SERVES CUSTOMERS."

—Myrtha, Qwest Sales/Service Consultant

**NOW HERE'S THE ACTION BEHIND THE WORDS:**

We maintain a 24-hour customer self-help line

We stay open on Saturdays and later on weekdays for home service

We have live repair service representatives available 24/7

We have a newly designed Web site, MyQwest.com, which you can customize to manage your account

We bring you simplicity and savings on local phone, wireless and high-speed Internet service, all on one bill with just one number to call

And we have more service improvements on the way

Qwest.
*Spirit of Service™*

MAKING IT EASIER FOR YOU TO DO BUSINESS WITH US. VISIT QWEST.COM

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# "CUSTOMER SERVICE THAT REALLY SERVES CUSTOMERS."

—Myrtha, Qwest Sales Consultant

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Qwest.
Spirit of Service™

MAKING IT EASIER FOR YOU TO DO BUSINESS WITH US. VISIT QWEST.COM

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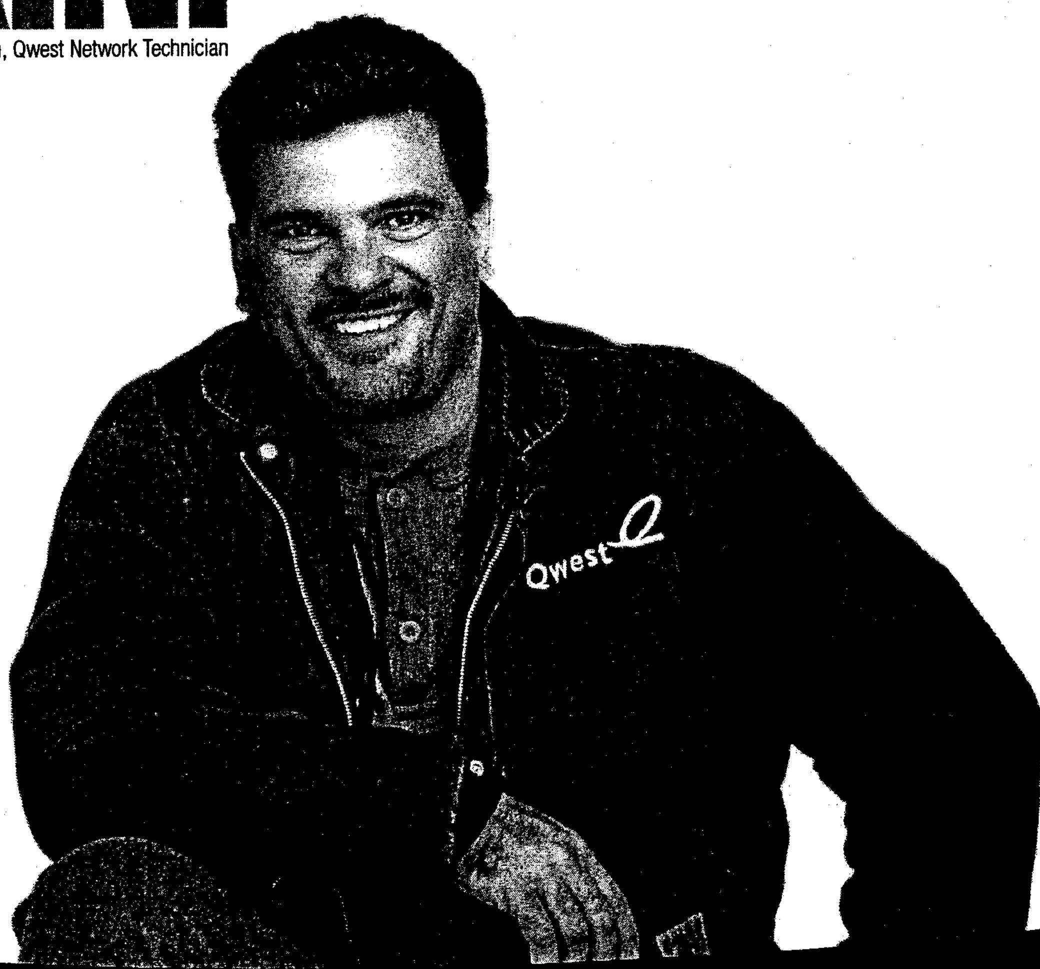
# "WE CALL. WE CARE. WE CALL AGAIN."

—Jim, Qwest Network Technician




**NOW WE CALL BEFORE AND AFTER EVERY SERVICE VISIT.**

A reminder call the night before • A courtesy call before a technician arrives at your door—at home or your small business
If your phone is out, we'll call your cell phone or a neighbor's number • A follow-up call to make sure you're satisfied

Qwest.
*Spirit of Service™*

MAKING IT EASIER FOR YOU TO DO BUSINESS WITH US. VISIT QWEST.COM

Arizona
T-01051B-03-0454 and T-00000D-00-0672
UTI 04-030

INTERVENOR: Utilitech, Inc.

REQUEST NO: 030

Has the Company (QC, QSC, QCII and other affiliates) conducted or otherwise obtained any studies of the effectiveness of its non-product specific advertising/marketing programs since January 1, 2003? If affirmative, please list all such studies and provide complete copies of same.

RESPONSE:

Yes. See Confidential Attachments A through G.

Respondent: Renee Karson

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Arizona
T-01051B-03-0454 and T-00000D-00-0672
UTI 14-006

INTERVENOR: Utilitech, Inc.

REQUEST NO: 006

Were any studies of Qwest's corporate image, branding, customer perceptions or positioning in the marketplace conducted by or for the Company (or any of its affiliates) prior to the decision to commence the "Spirit of Service" campaign? If affirmative, please identify each such study and provide complete copies of reports, analyses, presentation graphics, surveys, memoranda and other documents associated with each study.

RESPONSE:

Objection. This request is not reasonably calculated to lead to the discovery of admissible evidence concerning issues related to the modification, renewal or termination of the Price Cap Plan. Therefore, this request is overly broad and unduly burdensome because it seeks information beyond the scope of this proceeding. Without waiving this objection, Qwest provides the following response:

See Confidential Attachment A for the "Summary of 2002 JD Power Local Wireline Study-August 1, 2002 Confernce Call",

See Confidential Attachment B for the "Qwest Brand Evaluation Groups Report of Findings" which is from focus groups conducted in July, 2002.

Respondent: Renee Karson, Director Marketing

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QWEST CORPORATION FORM 10-Q TABLE OF CONTENTS

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended March 31, 2004**

**Or**

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from to**

**Commission File No. 001-03040**

# QWEST CORPORATION

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Colorado**<br>(State or other jurisdiction of incorporation or organization) | **84-0273800**<br>(I.R.S. Employer Identification No.) |
| **1801 California Street, Denver, Colorado**<br>(Address of principal executive offices) | **80202**<br>(Zip Code) |

**(303) 992-1400**
(Registrant's telephone number, including area code)

**N/A**
(Former name, former address and former fiscal year, if changed since last report)

THE REGISTRANT, A WHOLLY OWNED SUBSIDIARY OF QWEST COMMUNICATIONS INTERNATIONAL INC., MEETS THE CONDITIONS SET FORTH IN GENERAL INSTRUCTIONS H(1)(a) AND (b) OF FORM 10-Q AND IS THEREFORE FILING THIS FORM WITH REDUCED DISCLOSURE FORMAT PURSUANT TO GENERAL INSTRUCTIONS H(2).

**Note 5: Commitments and Contingencies**

***Legal Proceedings Involving Qwest***

**Securities Action**

On June 27, 2002, a putative class action was filed in the District Court for the County of Boulder against us, QCII, The Anschutz Family Investment Co., Philip Anschutz, Joseph P. Nacchio and Robin R. Szeliga on behalf of purchasers of QCII's stock between June 28, 2000 and June 27, 2002 and owners of U S WEST stock on June 28, 2000. The complaint alleges, among other things, that QCII and the individual defendants issued false and misleading statements and engaged in improper accounting practices in order to accomplish QCII's June 30, 2000 acquisition of U S WEST, Inc. ("the Merger") to make QCII appear successful and to inflate the value of QCII's stock. The complaint asserts claims under sections 11, 12, 15 and 17 of the Securities Act. The complaint seeks unspecified monetary damages, disgorgement of illegal gains and other relief. On July 31, 2002, the defendants removed this state court action to federal district court in Colorado and subsequently moved to consolidate this action with the consolidated securities action identified below. The plaintiffs have moved to remand the lawsuit back to state court. Defendants have opposed that motion, which is pending before the court.

**Regulatory Matters**

On February 14, 2002, the Minnesota Department of Commerce filed a formal complaint against us with the Minnesota Public Utilities Commission ("Minnesota Commission"), alleging that we, in contravention of federal and state law, failed to file interconnection agreements with the Minnesota Commission relating to certain of our wholesale customers, and thereby allegedly discriminated against other competitive local exchange carriers ("CLECs"). On November 1, 2002, the Minnesota Commission issued a written order adopting in full a proposal by an administrative law judge that we committed 26 individual violations of federal law by failing to file, as required under section 252 of the Telecommunications Act, 26 distinct provisions found in 12 separate agreements with individual CLECs for regulated services in Minnesota. The order also found that we agreed to provide and did provide to McLeodUSA, Inc. and Eschelon Telecom, Inc. discounts on regulated wholesale services of up to 10% that were not made available to other CLECs, thereby unlawfully discriminating against them. The order found we also violated state law, that the harm caused by our conduct extended to both customers and competitors, and that the damages to CLECs would amount to several million dollars for Minnesota alone.

On February 28, 2003, the Minnesota Commission issued its initial written decision imposing fines and penalties, which was later revised on April 8, 2003 to include a fine of nearly $26 million and ordered us to:

- grant a 10% discount off all intrastate Minnesota wholesale services to all CLECs other than Eschelon and McLeodUSA; this discount would be applicable to purchases made by these CLECs during the period beginning on November 15, 2000 and ending on May 15, 2002;
- grant all CLECs other than Eschelon and McLeodUSA monthly credits of $13 to $16 per unbundled network element-platform line (subject to certain offsets) purchased during the months of November 2000 through February 2001;
- pay all CLECs other than Eschelon and McLeodUSA monthly credits of $2 per access line (subject to certain offsets) purchased during the months of July 2001 through February 2002; and
- allow CLECs to opt-in to agreements the Minnesota Commission determined should have been publicly filed.

The Minnesota Commission issued its final, written decision setting forth the penalties and credits desc 2003. On June 19, 2003, we appealed the Minnesota Commission's orders to the United States District Court for the District of Minnesota. The appeal is pending.

Arizona, Colorado, New Mexico, Washington, Iowa and South Dakota have also initiated formal proceedings regarding our alleged failure to file required agreements in those states. New Mexico has issued an order providing its interpretation of the standard for filing these agreements, identified certain of our contracts as coming within that standard and opened a separate docket to consider further proceedings. On April 29, 2004, the New Mexico Staff filed comments recommending penalties totaling $5.05 million. Colorado has also opened an investigation into these matters, and on February 27, 2004, the Staff of the Colorado Public Utilities Commission ("PUC") submitted its Initial Comments. The Colorado Staff's Initial Comments recommended that the PUC open a show cause proceeding based upon the Staff's view that Qwest and CLECs had willfully and intentionally violated federal and state law and Commission rules. The Staff also detailed a range of remedies available to the Commission, including but not limited to an assessment of penalties and an obligation to extend credits to CLECs. On April 15, 2004, Qwest and the Office of Consumer Counsel for Colorado entered into a settlement, subject to Commission approval, that would require Qwest to pay $7.5 million in contributions to state telecommunications programs to resolve claims relating to potential penalties in the docket and that offers CLECs credits that could total approximately $9 million. During an open meeting on April 21, 2004, the Arizona Corporation Commission entered final orders upon consideration of recommended orders of the administrative law judge and a settlement between Qwest and three CLECs that was filed with the Commission on April 14, 2004. The Commission ordered Qwest to issue bill credits or pay cash totaling approximately $11.7 million to Arizona CLECs on the basis of the settlement, and also ordered Qwest to pay penalties of $9 million to the state treasury. On June 26, 2003, we received from the Federal Communications Commission ("FCC") a letter of inquiry seeking information about related matters. We submitted our initial response to this inquiry on July 31, 2003. On March 12, 2004, the FCC issued a Notice of Apparent Liability which recommended penalties of $9 million for alleged delays in filing 46 agreements in Arizona and Minnesota. Our response is due May 12, 2004. The proceedings and investigations in New Mexico, Colorado and Washington and at the FCC could result in the imposition of fines and other penalties against us that could be material. Iowa and South Dakota have concluded their inquiries resulting in no imposition of penalties or obligations to issue credits to CLECs in those states. Also, some telecommunications providers have filed private actions based on facts similar to those underlying these administrative proceedings. These private actions, together with any similar, future actions, could result in additional damages and awards that could be significant.

Illuminet, Inc., a traffic aggregator, and several of its customers have filed complaints with regulatory agencies in Idaho, Nebraska, Iowa, North Dakota and New Mexico, alleging that they are entitled to refunds due to our purported improper implementation of tariffs governing certain signaling services we provide in those states. The commissions in Idaho and Nebraska have ruled in favor of Illuminet and awarded it $1.5 million and $4.8 million, respectively. We sought reconsideration in both states, which was denied and subsequently we perfected appeals in both states. The proceedings in the other states and in states where Illuminet has not yet filed complaints could result in agency decisions requiring additional refunds. In addition, Nextel has filed an arbitration requesting refunds due to alleged improper implementation of the signaling services.

As a part of the approval by the FCC of the Merger, the FCC required QCII to engage an independent au... attestation review of our compliance with our divestiture of in-region InterLATA services and our ongoing compliance with Section 271 of the Telecommunications Act. In 2001, the FCC began an investigation of QCII's compliance with the divestiture of in-region InterLATA services and our ongoing compliance with Section 271 for the audit years 2000 and 2001. In connection with this investigation, QCII disclosed certain matters to the FCC that occurred in 2000, 2001, 2002 and 2003. These matters were resolved with the issuance of a consent decree on May 7, 2003, by which the investigation was concluded. As part of the consent decree, QCII made a voluntary payment to the U.S. Treasury in the amount of $6.5 million, and agreed to a compliance plan for certain future activities. Separate from this investigation, QCII disclosed matters to the FCC in connection with its 2002 compliance review, including a change in traffic flow related to wholesale transport for operator services traffic and certain toll-free traffic, certain bill mis-labeling for commercial credit card bills, and certain billing errors for public telephone services originating in South Dakota and for toll free services. If the FCC institutes an investigation into the latter categories of matters, it could result in the imposition of fines and other penalties against QCII. Separately, the FCC has also instituted an investigation into whether QCII may have impermissibly engaged in the marketing of InterLATA services in Arizona prior to receiving FCC approval of QCII's application to provide such services in that state.

We have other regulatory actions pending in local regulatory jurisdictions, which call for price decreases, refunds or both. These actions are generally routine and incidental to our business.

**Other Matters**

From time to time we receive complaints and become subject to investigations regarding "slamming" (the practice of changing long-distance carriers without the customer's consent), "cramming" (the practice of charging a consumer for goods or services that the consumer has not authorized or ordered) and other sales practices. In 2003, we resolved allegations and complaints of slamming and cramming with the Attorneys General for the states of Arizona, Colorado, Idaho, Oregon, Utah and Washington. In each of those states, we agreed to comply with certain terms governing our sales practices and to pay each of the states between $200,000 and $3.75 million. We may become subject to other investigations or complaints in the future and any such complaints or investigations could result in further legal action and the imposition of fines, penalties or damage awards.

We are subject to a number of environmental matters as a result of our prior operations as part of the Bell System. We believe that expenditures in connection with remedial actions under the current environmental protection laws or related matters will not be material to our business or financial condition.

***Legal Proceedings Involving QCII***

QCII is involved in several investigations, securities actions and other matters that, if resolved against QCII, could have a material adverse effect on our business and financial condition. These matters are more fully described below.

**Investigations, Securities Actions and Derivative Actions**

The investigations and securities actions described below present material and significant risks to QCII. The size, scope and nature of the recent restatements of our and QCII's consolidated financial statements for fiscal 2001 and 2000 affect the risks presented by these matters, and we can give no assurance as to the impacts on our and QCII's financial results or financial condition that may ultimately result from these matters. As QCII has previously disclosed, it has engaged in preliminary discussions for purposes of resolving certain of these matters. QCII recently concluded that a reserve should be provided. Accordingly, QCII has recorded a reserve in its consolidated financial statements for the estimated minimum liability associated with certain of these matters. However, the ultimate outcomes of these matters are still uncertain and there is a significant possibility that the amount of loss it ultimately incurs could be substantially more than the reserve it has provided.

QCII believes that it is probable that all but $100 million of the recorded reserve will be recoverable out of a portion of $200 million of insurance proceeds, consisting of $143 million of cash and $57 million of irrevocable letters of credit, that were placed in a trust to cover its losses and the losses of individual insureds following its November 12, 2003 settlement of disputes with certain of its insurance carriers related to, among other things, the investigations and securities and derivative actions described below. However, the use and allocation of these proceeds has yet to be resolved between it and individual insureds.

The securities actions are in a preliminary phase and QCII continues to defend against these matters vigorously. QCII has not yet conducted discovery on damages and other relevant issues. QCII is currently unable to provide any estimate as to the timing of the resolution of any of these matters. Any settlement of or judgment in one or more of these matters in excess of QCII's recorded reserves could be significant, and QCII can give no assurance that it will have the resources available to pay any such judgment. In the event of an adverse outcome in one or more of these matters, QCII's ability to meet its debt service obligations and its financial condition could be materially and adversely affected. As a wholly owned subsidiary of QCII, our business operations and financial condition would be similarly affected.

**Investigations**

On April 3, 2002, the Securities and Exchange Commission ("SEC") issued an order of investigation that made formal an informal investigation of QCII initiated on March 8, 2002. QCII is continuing in its efforts to cooperate fully with the SEC in its investigation. The investigation includes, without limitation, inquiry into several specifically identified QCII accounting practices and transactions and related disclosures that are the subject of the various adjustments and restatements described in the QCII annual report in Form 10-K for the year ended December 31, 2002. The investigation also includes inquiry into disclosure and other issues related to transactions between QCII and certain of its vendors and certain investments in the securities of those vendors by individuals associated with QCII.

On July 9, 2002, QCII was informed by the U.S. Attorney's Office for the District of Colorado of a criminal investigation of its business. QCII believes the U.S. Attorney's Office is investigating various matters that include the subjects of the investigation by the SEC. QCII is continuing in its efforts to cooperate fully with the U.S. Attorney's Office in its investigation.

During 2002, the United States Congress held hearings regarding QCII and matters that are similar to those being investigated by the SEC and the U.S. Attorney's Office. QCII cooperated fully with Congress in connection with those hearings.

While QCII is continuing in its efforts to cooperate fully with the SEC and the U.S. Attorney's Office in each of their respective investigations, QCII cannot predict the outcome of those investigations. QCII has engaged in discussions with the SEC staff in an effort to resolve the issues raised in the SEC's investigation of it. Such discussions are preliminary and QCII cannot predict the likelihood of whether those discussions will result in a settlement and, if so, the terms of such settlement. However, settlements typically involve, among other things, the SEC making claims under the federal securities laws in a complaint filed in United States District Court that, for purposes of the settlement, the defendant neither admits nor denies. Were such a settlement to occur, QCII would expect such claims to address many of the accounting practices and transactions and related disclosures that are the subject of the various restatements QCII has made as well as additional transactions. In addition, any settlement with the SEC may also involve, among other things, the imposition of disgorgement and a civil penalty, the amounts of which could be substantially in excess of QCII's recorded reserve, and the entry of a court order that would require, among other things, that QCII and its officers and directors comply with provisions of the federal securities laws as to which there have been allegations of prior violations.

In addition, as previously reported, the SEC has conducted an investigation concerning QCII's earnings release for the fourth quarter and full year 2000 issued on January 24, 2001. The release provided pro forma normalized earnings information that excluded certain nonrecurring expense and income items resulting primarily from the Merger. On November 21, 2001, the SEC staff informed QCII of its intent to recommend that the SEC authorize an action against QCII that would allege it should have included in the earnings release a statement of its earnings in accordance with GAAP. At the date of this filing, no action has been taken by the SEC. However, QCII expects that if its current discussions with the staff of the SEC result in a settlement, such settlement will include allegations concerning the January 24, 2001 earnings release.

Also, as the General Services Administration ("GSA"), previously announced in July 2002, it is conducting a review of all contracts with QCII for purposes of determining present responsibility. On September 12, 2003, QCII was informed that the Inspector General of the GSA had referred to the GSA Suspension/Debarment Official the question of whether QCII (including us and its other subsidiaries) should be considered for debarment. QCII has been informed that the basis for the referral was the February 2003 indictment against four former QCII employees in connection with a transaction with the Arizona School Facilities Board in June 2001 and a civil complaint also filed in February 2003 by the SEC against the same former employees and others relating to the Arizona School Facilities Board transaction and a transaction with Genuity Inc. in 2000. QCII is cooperating fully with the GSA and believes that it and we will remain suppliers of the government, although QCII cannot predict the outcome of this referral.

**Securities Actions and Derivative Actions**

Since July 27, 2001, 13 putative class action complaints have been filed in federal district court in Colorado against QCII alleging violations of the federal securities laws. One of those cases has been dismissed. By court order, the remaining actions have been consolidated into a consolidated securities action, which we refer to herein as the "consolidated securities action."

On August 21, 2002, plaintiffs in the consolidated securities action filed their Fourth Consolidated Amended Class Action Complaint ("Fourth Consolidated Complaint"), which defendants moved to dismiss. On January 13, 2004, the United States District Court for the District of Colorado granted the defendants' motions to dismiss in part and denied them in part. In that order, the court allowed plaintiffs to file a proposed amended complaint seeking to remedy the pleading defects addressed in the court's dismissal order and ordered that discovery, which previously had been stayed during the pendency of the motions to dismiss, proceed regarding the surviving claims. On February 6, 2004, plaintiffs filed a Fifth Consolidated Amended Class Action Complaint ("Fifth Consolidated Complaint"). The Fifth Consolidated Complaint attempts to expand the putative class period previously alleged in the Fourth Consolidated Complaint, seeks to restore the claims dismissed by the court, including claims against certain individual defendants who were dismissed as defendants by the court's dismissal order, and to add additional individual defendants who have not been named as defendants in plaintiffs' previous complaints. The Fifth Consolidated Complaint also advances allegations related to a number of matters and transactions that were not pleaded in the earlier complaints. The Fifth Consolidated Complaint is purportedly brought on behalf of purchasers of publicly traded securities of QCII between May 24, 1999 and July 28, 2002, and names as defendants QCII, QCII's former Chairman and Chief Executive Officer, Joseph P. Nacchio, QCII's former Chief Financial Officers, Robin R. Szeliga and Robert S. Woodruff, other of QCII's former officers and current directors and

Arthur Andersen LLP. The Fifth Consolidated Complaint alleges, among other things, that during the putative class period, QCII and certain of the individual defendants made materially false statements regarding the results of QCII's operations in violation of section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), that certain of the individual defendants are liable as control persons under section 20(a) of the Exchange Act, and that certain of the individual defendants sold some of their shares of QCII's common stock in violation of section 20A of the Exchange Act. The Fifth Consolidated Complaint further alleges that QCII and certain other defendants violated section 11 of the Securities Act of 1933, as amended ("Securities Act") by preparing and disseminating false registration statements and prospectuses for the registration of QCII common stock to be issued to U S WEST shareholders in connection with the merger of the two companies, and for the exchange of $3 billion of QCII's notes pursuant to a registration statement dated January 17, 2001, $3.25 billion of QCII's notes pursuant to a registration statement dated July 12, 2001, and $3.75 billion of QCII's notes pursuant to a registration statement dated October 30, 2001. Additionally, the Fifth Consolidated Complaint alleges that certain of the individual defendants are liable as control persons under section 15 of the Securities Act by reason of their stock ownership, management positions and/or membership or representation on QCII's Board of Directors. The Fifth Consolidated Complaint seeks unspecified compensatory damages and other relief. However, counsel for plaintiffs has indicated that the purported class will seek damages in the tens of billions of dollars. On March 8, 2004, QCII and other defendants filed motions to dismiss the Fifth Consolidated Complaint.

Since March 2002, seven putative class action suits were filed in federal district court in Colorado purportedly on behalf of all participants and beneficiaries of the Qwest Savings and Investment Plan and predecessor plans, (the "Plan"), from March 7, 1999 until the present. By court order, five of these putative class actions have been consolidated and the claims made by the plaintiff in the sixth case were subsequently included in the Second Amended and Consolidated Complaint ("Second Consolidated Complaint"), filed on May 21, 2003 and referred to as the "consolidated ERISA action". QCII expects the seventh putative class action to be consolidated with the other cases since it asserts substantially the same claims. Defendants in this matter include QCII, several former and current directors and certain former officers of QCII, as well as Qwest Asset Management, QCII's Plan Design Committee, the Plan Investment Committee and the Plan Administrative Committee of the pre-Merger QCII 401(k) Savings Plan. The consolidated ERISA action, which is brought under the Employee Retirement Income Security Act alleges, among other things, that the defendants breached fiduciary duties to the Plan members by allegedly excessively concentrating the Plan's assets invested in QCII's stock, requiring certain participants in the Plan to hold the matching contributions received from QCII in the Qwest Shares Fund, failing to disclose to the participants the alleged accounting improprieties that are the subject of the consolidated securities action, failing to investigate the prudence of investing in QCII's stock, continuing to offer QCII's stock as an investment option under the Plan, failing to investigate the effect of the Merger on Plan assets and then failing to vote the Plan's shares against it, preventing Plan participants from acquiring QCII's stock during certain periods, and, as against some of the individual defendants, capitalizing on their private knowledge of QCII's financial condition to reap profits in stock sales. Plaintiffs seek equitable and declaratory relief, along with attorneys' fees and costs and restitution. Plaintiffs moved for class certification on January 15, 2003, and QCII has opposed that motion, which is pending before the court. Defendants filed motions to dismiss the consolidated ERISA action on August 22, 2002. Those motions are also pending before the court.

On December 10, 2002, the California State Teachers' Retirement System ("CalSTRS") filed suit against QCII, certain of QCII's former officers and certain of QCII's current directors and several other defendants, including Arthur Andersen LLP and several investment banks, in the Superior Court of the State of California in and for the County of San Francisco. CalSTRS alleged that the defendants engaged in fraudulent conduct that caused CalSTRS to lose in excess of $150 million invested in QCII's equity and debt securities. The complaint alleges, among other things, that defendants engaged in a scheme to falsely inflate QCII's revenue and decrease its expenses so that QCII would appear more successful than it actually was during the period in which CalSTRS purchased and sold QCII securities. The complaint purported to state causes of action against QCII for (i) violation of California Corporations Code section 25400 et seq. (securities laws); (ii) violation of California Corporations Code section 17200 et seq. (unfair competition); (iii) fraud, deceit and concealment; and (iv) breach of fiduciary duty. Among other requested relief, CalSTRS sought compensatory, special and punitive damages, restitution, pre-judgment interest and costs. QCII and the individual defendants filed a demurrer, seeking dismissal of all claims. In response, CalSTRS voluntarily dismissed the unfair competition claim but maintained the balance of the complaint. The court denied the demurrer as to the California securities law and fraud claims, but dismissed the breach of fiduciary duty claim against QCII with leave to amend. The court also dismissed the claims against Robert S. Woodruff and Robin R. Szeliga on jurisdictional grounds. On or about July 25, 2003, plaintiff filed a First Amended Complaint. The material allegations and the relief sought remain largely the same, but plaintiff no longer alleges claims against Mr. Woodruff and Ms. Szeliga following the court's dismissal of the claims against them. CalSTRS reasserted its claim against QCII for breach of fiduciary duty as a claim of aiding and abetting breach of fiduciary duty. QCII filed a second demurrer to that claim, and on November 17, 2003, the court dismissed that claim without leave to amend.

On November 27, 2002, the State of New Jersey (Treasury Department, Division of Investment) ("New Jersey") filed a lawsuit similar to the CalSTRS action in New Jersey Superior Court, Mercer County. On October 17, 2003, New Jersey filed an amended complaint alleging, among other things, that QCII, certain of QCII's former officers and certain current directors and Arthur Andersen LLP caused QCII's stock to trade at artificially inflated prices by employing improper accounting practices, and by issuing false statements about QCII's business, revenues and profits. As a result, New Jersey contends that it incurred hundreds of millions of dollars in losses. New Jersey's complaint purports to state causes of action against QCII for: (i) fraud; (ii) negligent misrepresentation; and (iii) civil conspiracy. Among other requested relief, New Jersey seeks from the defendants, jointly and severally, compensatory, consequential, incidental and punitive damages. On November 17, 2003, QCII filed a motion to dismiss. That motion is pending before the court.

On January 10, 2003, the State Universities Retirement System of Illinois ("SURSI") filed a lawsuit similar to the CalSTRS and New Jersey lawsuits in the Circuit Court of Cook County, Illinois. SURSI filed suit against QCII, certain of QCII's former officers and certain current directors and several other defendants, including Arthur Andersen LLP and several investment banks. On October 29, 2003, SURSI filed a second amended complaint which alleges, among other things, that defendants engaged in fraudulent conduct that caused it to lose in excess of $12.5 million invested in QCII's common stock and debt and equity securities and that defendants engaged in a scheme to falsely inflate QCII's revenues and decrease its expenses by improper conduct related to transactions with the Arizona School Facilities Board, Genuity, Calpoint LLC, KMC Telecom Holdings, Inc., KPNQwest N.V., and Koninklijke KPN, N.V. The second amended complaint purports to state the following causes of action against QCII: (i) violation of the Illinois Securities Act; (ii) common law fraud; (iii) common law negligent misrepresentation; and (iv) violation of section 11 of the Securities Act. SURSI seeks, among other relief, punitive and exemplary damages, costs, equitable relief, including an injunction to freeze or prevent disposition of the defendants' assets, and disgorgement. All the individual defendants moved to dismiss the action against them for lack of personal jurisdiction. To date, neither QCII nor the individual defendants have filed a response to the second amended complaint, and the Illinois' court's schedule does not contemplate that answers or motions to dismiss be filed until after the challenges to jurisdiction have been resolved.

On February 9, 2004, Stichting Pensioenfonds ABP ("SPA") filed suit against QCII, certain of QCII's current and former directors, officers, and employees, as well as several other defendants, including Arthur Andersen LLP, Citigroup Inc. and various affiliated corporations of Citigroup Inc., in the United States District Court for the District of Colorado. SPA alleges that the defendants engaged in fraudulent conduct that caused SPA to lose more than $100 million related to SPA's investments in QCII's equity securities purchased between July 5, 2000 and March 11, 2002. The complaint alleges, among other things, that defendants created a false perception of QCII's revenues and growth prospects. SPA alleges claims against QCII and certain of the individual defendants for violations of sections 18 and 10(b) of the Exchange Act and SEC Rule 10b-5, violations of the Colorado Securities Act and common law fraud, misrepresentation and conspiracy. The complaint also contends that certain of the individual defendants are liable as "control persons" because they had the power to cause QCII to engage in the unlawful conduct alleged by plaintiffs in violation of section 20(a) of the Exchange Act, and alleges other claims against defendants other than QCII. SPA seeks, among other things, compensatory and punitive damages, rescission or rescissionary damages, pre-judgment interest, fees and costs. On April 19, 2004, defendants filed motions to dismiss, which are pending before the court.

On March 22, 2004, Shriners Hospital for Children, ("SHC") filed suit against QCII, certain of its former employees, and certain unidentified persons in the District Court for the City and County of Denver. SHC alleges that the defendants engaged in fraudulent conduct by a variety of actions, including issuing false and misleading financial statements. The complaint alleges claims against QCII and the other defendants based upon Colorado state securities laws, common law fraud, and negligent misrepresentation. SHC alleges damages of $17 million. SHC seeks compensatory and punitive damages, interests, costs and attorneys' fees. On April 16, 2004, defendants removed this case to the United States District Court for the District of Colorado, where it is now pending.

On or about March 30, 2004, Teachers' Retirement System of Louisiana,("TRSL") filed suit against QCII in the District Court for the City and County of Denver. The allegations of the TRSL complaint are substantially the same as the suit filed against QCII by SHC, except that TRSL alleges damages of $17 to $23 million. On April 16, 2004, defendants removed this case to the United States District Court for the District of Colorado, where it is now pending.

On October 22, 2001, a purported derivative lawsuit was filed in the United States District Court for the District of Colorado, or the Federal Derivative Litigation. On February 6, 2004, a third amended complaint was filed in the Federal Derivative Litigation, naming as defendants certain of QCII's present and former directors and certain former officers and naming QCII as a nominal defendant. The Federal Derivative Litigation is based upon the allegations made in the consolidated securities action and alleges, among other things, that the defendants breached their fiduciary duties to QCII by engaging in self-dealing, insider trading, usurpation of corporate opportunities, failing to oversee implementation of securities laws that prohibit insider trading, failing to maintain appropriate financial controls within QCII, and causing or permitting QCII to commit alleged securities violations, thus (1) causing QCII to be sued for such violations and (2) subjecting QCII to adverse publicity, increasing its cost of raising capital and impairing earnings. On March 26, 2004, a proposed fourth amended complaint was filed in the Federal Derivative Litigation, which names additional defendants, including a former QCII officer, Citigroup Inc. and corporations affiliated with Citigroup, Inc. The proposed fourth amended complaint contains allegations in addition to those set forth in the third amended complaint, including that certain individual defendants violated securities laws as a result of the filing of false and misleading proxy statements by QCII from 2000 through 2003, and that the Citigroup defendants aided and abetted breaches of fiduciary duties owed to QCII. The Federal Derivative Litigation has been consolidated with the consolidated securities action. Plaintiff seeks, among other remedies, disgorgement of alleged insider trading profits.

On August 9, 2002, a purported derivative lawsuit was filed in the Court of Chancery of the State of Delaware. A separate alleged derivative lawsuit was filed in the Court of Chancery of the State of Delaware on or about August 28, 2002. On October 30, 2002, these two alleged derivative lawsuits, or collectively, the Delaware Derivative Litigation, were consolidated. The Second Amended Complaint in the Delaware Derivative Litigation was filed on or about January 23, 2003, naming as defendants certain of QCII's current and former officers and directors and naming QCII as a nominal defendant.

In the Second Amended Complaint the plaintiffs allege, among other things, that the individual defendants: (i) breached their fiduciary duties by allegedly engaging in illegal insider trading in QCII's stock; (ii) failed to ensure compliance with federal and state disclosure, anti-fraud and insider trading laws within QCII, resulting in exposure to it; (iii) appropriated corporate opportunities, wasted corporate assets and self-dealt in connection with investments in initial public offering securities through QCII's investment bankers; and (iv) improperly awarded severance payments to QCII's former Chief Executive Officer, Mr. Nacchio and QCII's former Chief Financial Officer, Mr. Woodruff. The plaintiffs seek recovery of incentive compensation allegedly wrongfully paid to certain defendants, all severance payments made to Messrs. Nacchio and Woodruff, disgorgement, contribution and indemnification, repayment of compensation, injunctive relief, and all costs including legal and accounting fees. On March 17, 2003, defendants moved to dismiss the Second Amended Complaint, or, in the alternative, to stay the action. As described below, a proposed settlement of the Delaware Derivative Litigation has been reached.

On each of March 6, 2002 and November 22, 2002, a purported derivative action was filed in Denver District Court, which we refer to collectively as the Colorado Derivative Litigation. On February 5, 2004, plaintiffs in one of these cases filed an amended complaint naming as defendants certain of QCII's current and former officers and directors and Anschutz Company, and naming QCII as a nominal defendant. The two purported derivative actions were consolidated on February 17, 2004. The amended complaint alleges, among other things, that various of the individual defendants breached their legal duties to QCII by engaging in various kinds of self-dealings, failing to oversee compliance with laws that prohibit insider trading and self-dealing, and causing or permitting QCII to commit alleged securities laws violations, thereby causing QCII to be sued for such violations and subjecting QCII to adverse publicity, increasing its cost of raising capital and impairing earnings.

Beginning in May 2003, the parties to the Colorado Derivative Litigation and the Delaware Derivative Litigation participated in a series of mediation sessions with former United States District Judge Layn R. Phillips. On November 14, 2003, as a result of this process, the parties agreed in principle upon a settlement of the claims asserted in the Colorado Derivative Litigation and the Delaware Derivative Litigation, subject to approval and execution of formal settlement documents, approval by the Denver District Court and dismissal with prejudice of the Colorado Derivative Litigation, the Delaware Derivative Litigation and the Federal Derivative Litigation. From November 14, 2003 until February 17, 2004, the parties engaged in complex negotiations to resolve the remaining issues concerning the potential settlement. On February 17, 2004, the parties reached a formal Stipulation of Settlement, which was filed with the Denver District Court. The stipulation of settlement provides, among other things, that if approved by the Denver District Court and upon dismissal with prejudice of the Delaware Derivative Litigation and the Federal Derivative Litigation, $25 million of the $200 million fund from the insurance settlement with certain of QCII's insurance carriers will be designated for the exclusive use of QCII to pay losses and QCII will implement a number of corporate governance changes. (The $200 million has been placed in trust to cover losses QCII may incur and the losses of current and former directors and officers and others who release the carriers in connection with the settlement.) The Stipulation of Settlement also provides that the Denver District Court may enter awards of attorneys' fees and costs to derivative plaintiffs' counsel from the $25 million in amounts not to exceed $7.5 million and $125,000, respectively. On February 17, 2004, the Denver District Court entered a Preliminary Approval Order and scheduled a hearing to take place on June 15, 2004, to consider final approval of the proposed settlement and derivative plaintiffs' counsels' request for an award of fees and costs.

On or about February 23, 2004, plaintiff in the Federal Derivative Litigation filed a motion in the United States District Court for the District of Colorado to enjoin further proceedings relating to the proposed settlement of the Colorado Derivative Litigation, or alternatively, to enjoin the enforcement of a provision in the Preliminary Approval Order of the Denver District Court which plaintiff claims would prevent the Federal Derivative Litigation from being prosecuted pending a final determination of whether the settlement of the Colorado Derivative Litigation shall be approved. On March 8, 2004, the individual defendants in the Federal Derivative Litigation filed a motion to stay all proceedings in that action pending a determination by the Denver District Court whether to approve the proposed settlement of the derivative claims asserted in the Colorado Derivative Litigation.

**Other Matters**

In January 2001, an amended purported class action complaint was filed in Denver District Court against QCII and certain current and former officers and directors on behalf of stockholders of U S WEST. The complaint alleges that QCII had a duty to pay a quarterly dividend to U S WEST stockholders of record as of June 30, 2000. Plaintiffs further claim that the defendants attempted to avoid paying the dividend by changing the record date from June 30, 2000 to July 10, 2000, a claim QCII denies. In September 2002, QCII filed a motion for summary judgment on all claims. Plaintiffs filed a cross-motion for summary judgment on their breach of contract claims only. On July 15, 2003, the court denied both summary judgment motions. Plaintiffs' claims for breach of fiduciary duty and breach of contract remain pending. The case is now in the class certification stage, which QCII is challenging.

Several purported class actions relating to the installation of fiber optic cable in certain rights-of-way were filed in various courts against QCII on behalf of landowners in Alabama, California, Colorado, Georgia, Illinois, Indiana, Kansas, Louisiana, Mississippi, Missouri, North Carolina, Oregon, South Carolina, Tennessee and Texas. Class certification was denied in the Louisiana proceeding and, subsequently, summary judgment was granted in QCII's favor. A new Louisiana class action complaint has recently been filed. Class certification was also denied in the California proceeding, although plaintiffs have filed a motion for reconsideration. Class certification was granted in the Illinois proceeding. Class certification has not been resolved yet in the other proceedings. The complaints challenge QCII's right to install its fiber optic cable in railroad rights-of-way and, in Colorado, Illinois and Texas, also challenge QCII's right to install fiber optic cable in utility and pipeline rights-of-way. In Alabama, the complaint challenges QCII's right to install fiber optic cable in any right-of-way, including public highways. The complaints allege that the railroads, utilities and pipeline companies own a limited property right-of-way that did not include the right to permit QCII to install its fiber optic cable on the plaintiffs' property. The Indiana action purports to be on behalf of a national class of landowners adjacent to railroad rights-of-way over which QCII's network passes. The Alabama, California, Colorado, Georgia, Kansas, Louisiana, Mississippi, Missouri, North Carolina, Oregon, South Carolina, Tennessee and Texas actions purport to be on behalf of a class of such landowners in those states, respectively. The Illinois action purports to be on behalf of landowners adjacent to railroad rights-of-way over which QCII's network passes in Illinois, Iowa, Kentucky, Michigan, Minnesota, Nebraska, Ohio and Wisconsin. Plaintiffs in the Illinois action have filed a motion to expand the class to a nationwide class. The complaints seek damages on theories of trespass and unjust enrichment, as well as punitive damages. Together with some of the other telecommunication carrier defendants, in September 2002, QCII filed a proposed settlement of all these matters (except those in Louisiana) in the United States District Court for the Northern District of Illinois. On July 25, 2003, the court granted preliminary approval of the settlement and entered an order enjoining competing class action claims, except those in Louisiana. Accordingly, with the exception of the Louisiana actions, all other right of way actions are stayed. The settlement and the court's injunction are opposed by some, but not all, of the plaintiffs' counsel and are on appeal before the Seventh Circuit Court of Appeals. At this time, QCII cannot determine whether such settlement will be ultimately approved or the final cost of the settlement if it is approved.

On October 31, 2002, Richard and Marcia Grand, co-trustees of the R.M. Grand Revocable Living Trust, dated January 25, 1991, filed a lawsuit in Arizona Superior Court alleging that the defendants

# BEFORE THE ARIZONA CORPORATION COMMISSION

| | | |
|---|---|---|
| | ) | |
| **IN THE MATTER OF QWEST CORPORATION'S FILING AMENDED RENEWED PRICE REGULATION PLAN** | ) | **DOCKET NO. T-01051B-03-0454** |
| | ) | |
| | ) | |
| | ) | |
| **IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS** | ) | **DOCKET NO. T-00000D-00-0672** |
| | ) | |
| | ) | |

**STAFF JOINT ACCOUNTING SCHEDULES**

**ON BEHALF OF THE STAFF OF THE**
**ARIZONA CORPORATION COMMISSION**

**PUBLIC VERSION**
("Highlights" Denote Confidential Material)

PREPARED
BY
UTILITECH, INC.

**Filed: November 18, 2004**

**QWEST CORPORATION**
**DOCKET NO. T-01051B-03-0454**
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**AND SUPPORTING SCHEDULES**

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| | | |
| F | **INTRASTATE SEPARATION FACTORS** | Carver |

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
CHANGE IN GROSS REVENUE REQUIREMENT
TEST YEAR ENDING 12/31/2003
(000's)



| Line No. | Description | Reference | Qwest Proposed Original Cost (a) | Qwest Proposed Fair Value (a) | Staff Proposed Original Cost | Staff Proposed Fair Value |
|---|---|---|---|---|---|---|
| | (A) | (B) | (C) | (D) | (E) | (F) |
| 1 | Proposed Rate Base | Sch. B | $ 1,643,001 | $ 2,386,363 | $ 1,559,949 | $ 2,228,978 |
| 2 | Rate of Return | Sch. D | 11.18% | 11.18% | 9.50% | 6.65% |
| 3 | Operating Income Required | Line 1 * 2 | $ 183,688 | $ 266,795 | $ 148,132 | $ 148,132 |
| 4 | Net Operating Income Available | Sch. C | (5,056) | (5,056) | 146,044 | 146,044 |
| 5 | Operating Income Deficiency | Line 3 - 4 | $ 188,744 | $ 271,851 | $ 2,088 | $ 2,088 |
| 6 | Revenue Conversion Factor | Sch. A-1 | 1.6876 | 1.6876 | 1.6910 | 1.6910 |
| 7 | **Revenue Requirement** | Line 5 * 6 | **$ 318,529** | **$ 458,784** | **$ 3,530** | **$ 3,530** |
| 8 | Overall Percentage Increase | | 28.67% | | 0.32% | |

**FOOTNOTES:**

(a) Source: Qwest Schedule A-1, Rule 103 filing -- 6/21/04 update.

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
REVENUE CONVERSION FACTOR
TEST YEAR ENDING 12/31/2003

Schedule A-1
Page 1 of 1

| Line No. | Description | Reference | Company Proposed | ACC Staff Proposed |
|---|---|---|---|---|
| | (A) | (B) | (C) | (D) |
| 1 | Gross Intrastate Revenue | | 100.0000% | 100.0000% |
| 2 | Less: Uncollectible Revenue | Note b | -2.1220% | -1.8404% |
| 3 | Total Revenue | Ln1-Ln2 | 97.8780% | 98.1596% |
| 4 | Less: Taxes on Local Revenue Service | | -0.3646% | -0.3646% |
| 5 | Taxable Income | Ln3-Ln4 | 97.5134% | 97.7950% |
| 6 | Less: Effective State Income Tax | 6.9680% | 6.3521% | 6.8144% |
| 7 | Less: Effective Federal Income Tax | 32.5612% | 31.9065% | 31.8432% |
| 8 | Net Operating Earnings | Ln5-Ln6-Ln7 | 59.2548% | 59.1374% |
| 9 | Income to Revenue Multiplier | Ln 1/Ln 8 | 1.687627 (a) | 1.690976 |

**FOOTNOTES:**

**(a)** According to Qwest's response to Staff Data Request UTI 15-18, the Company's June 21, 2004 revised Rule 103 filing incorrectly quantifies the effective Federal and State income tax rates, which misstates the revenue conversion factor. The Company "proposed" multiplier of 1.6876 reflects the factor used in the referenced filing and does not represent the corrected factor of 1.695858 identified in the referenced response. Staff's revenue multiplier does reflect the correct effective income tax rates.

**(b)**

| | | |
|---|---|---|
| Intrastate Revenues - Local | 1990 Detail (LU) | 842,673,206 |
| Intrastate Revenues - Long Distance | 1990 Detail (LU) | 11,163,067 |
| Total Loc + LD Intrastate Revenues | | 853,836,273 |
| Uncollectible Revenues | 1990 Detail (LU) | 18,118,730 |
| Percent Uncollectible - Qwest Filing | | 2.1220% |
| Qwest Adjustment PFN-03 Uncollectibles | PFN-03 WPs | (2,405,000) |
| Adjusted Uncollectibles | | 15,713,730 |
| Adjusted Percent Uncollectible | | 1.8404% |

Witness: M. Brosch

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
FAIR VALUE PERCENTAGE CONDITION ADJUSTMENT
TEST YEAR ENDING 12/31/2003
(000's)



| Line No. | Description | Reference | Qwest Pro Forma Test Year | ACC Adjustments | ACC Proposed |
|---|---|---|---|---|---|
| | (A) | (B) | (C) | (D) | (E) |
| 1 | Fair Value Rate Base | Qwest Sch. B-1 | $ 2,386,363 | | |
| 2 | Staff Rate Base Accounting Adjustments | Sch B. pg. 3 | | $ (83,052) | |
| 3 | Add Back: Short Term Plant Under Construction | Footnote (a) | | 21,448 | |
| 4 | Staff Witness Dunkel RCND Study Adjustments | Sch. A-2 pg. 2 | | (95,780) | |
| 5 | Total Staff Fair Value Adjustments | Line 2 + 3 + 4 | | (157,385) | |
| 6 | STAFF PROPOSED FAIR VALUE RATE BASE | Line 1 + 5 | | | $ 2,228,978 |

**FOOTNOTES:**

**(a)** Qwest Sch. B-1 Fair Value Rate Base failed to include Short Term Plant Under Construction while Sch. B-3 includes such amount.

Witness: M. Brosch

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
FAIR VALUE PERCENTAGE CONDITION ADJUSTMENT
TEST YEAR ENDING 12/31/2003
(000's)



Includes Embedded, FCC Deregulated & Other Plant

| | | RCND Summary per Qwest Schedule B-4 | | | | Staff | Staff |
|---|---|---|---|---|---|---|---|
| Line No. | Description | Original Cost Incl Offbook | Reproduction Cost New | Condition Percent | Reproduction Cost New Less Depreciation | Condition Percent (Per WDA-17) | Reproduction Cost Less Depreciation |
| | (A) | (B) | (C) | (D) | (E) | (F) | (G) |
| 1 | Land | 12,813 | 12,813 | 100.00% | 12,813 | 100.00% | $ 12,813 |
| 2 | Motor Vehicles | 71,269 | 74,251 | 46.88% | 34,811 | 40.36% | 29,968 |
| 3 | Special Purpose Vehicles | 26 | 33 | 26.38% | 9 | 27.06% | 9 |
| 4 | Garage Work Equipment | 1,519 | 1,821 | 64.47% | 1,174 | 64.93% | 1,182 |
| 5 | Other Work Equipment | 38,319 | 40,359 | 56.35% | 22,744 | 59.30% | 23,933 |
| 6 | Buildings | 238,452 | 432,300 | 65.44% | 282,893 | 59.83% | 258,645 |
| 7 | Furniture | 1,897 | 1,897 | 68.79% | 1,305 | 49.46% | 938 |
| 8 | Office Equipment | 5,913 | 6,123 | 37.83% | 2,316 | 19.88% | 1,217 |
| 9 | Company Communication Equipment | 2,429 | 2,566 | | | 43.80% | 1,124 |
| 10 | General Purpose Computers | 96,514 | 18,005 | 38.15% | 6,868 | 25.81% | 4,647 |
| 11 | Analog Switching | | | | | 0.00% | - |
| 12 | Digital Switching | 1,192,379 | 914,690 | 68.43% | 625,939 | 62.14% | 568,388 |
| 13 | Operator Systems | 2,534 | 2,902 | 36.53% | 1,060 | 30.99% | 899 |
| 14 | Radio Systems | 32,937 | 36,886 | 34.73% | 12,812 | 27.60% | 10,180 |
| 15 | Circuit DDS | 1,757,337 | 5,401 | 49.67% | 2,682 | 37.10% | 2,004 |
| 16 | Circuit Digital | | 1,690,094 | 76.36% | 1,290,497 | 55.05% | 930,397 |
| 17 | Circuit Analog | | 39,638 | 36.17% | 14,338 | 23.34% | 9,252 |
| 18 | Station Apparatus | 32,899 | 32,899 | 62.43% | 20,538 | 62.43% | 20,539 |
| 19 | Customer Premises Wiring | | | 0.00% | | 0.00% | - |
| 20 | Large PBX | | | | | | - |
| 21 | Public Telephone Terminal Equipment | 21,555 | 21,555 | 40.81% | 8,796 | 40.81% | 8,797 |
| 22 | Other Terminal Equipment | 61,166 | 59,208 | 92.47% | 54,749 | 58.10% | 34,400 |
| 23 | Poles | 52,723 | 199,908 | 57.95% | 115,855 | 63.94% | 127,821 |
| 24 | Aerial Cable - Metallic | 198,351 | 348,764 | 27.76% | 96,834 | 37.95% | 132,356 |
| 25 | Aerial Cable - Non-Metallic | 9,484 | 10,757 | 55.68% | 5,990 | 76.85% | 8,267 |
| 26 | Underground Cable - Metallic | 398,394 | 679,519 | 23.80% | 161,729 | 34.18% | 232,259 |
| 27 | Underground Cable - Non-Metallic | 183,141 | 199,445 | 50.74% | 101,205 | 75.32% | 150,222 |
| 28 | Buried Cable - Metallic | 1,645,740 | 2,178,731 | 43.13% | 939,667 | 47.94% | 1,044,484 |
| 29 | Buried Cable - Non-Metallic | 23,709 | 26,229 | 47.63% | 12,493 | 66.75% | 17,508 |
| 30 | Submarine Cable - Metallic | 3 | 5 | 0.00% | | 2.26% | 0 |
| 31 | Submarine Cable - Non-Metallic | | | | | | - |
| 32 | Intrabuilding Cable - Metallic | 46,456 | 80,436 | 38.22% | 30,741 | 26.78% | 21,541 |
| 33 | Intrabuilding Cable - Non-Metallic | 1,057 | 1,184 | 75.18% | 890 | 75.78% | 897 |
| 34 | Aerial Cable | 10,998 | 15,986 | 48.99% | 7,831 | 62.60% | 10,007 |
| 35 | Conduit | 451,409 | 878,335 | 56.31% | 494,618 | 56.33% | 494,766 |
| 36 | Capital Leases - Buildings | | | | | | - |
| 37 | Capital Leases - Vehicles | 16 | 16 | 100.00% | 16 | 100.00% | 16 |
| 38 | Capital Leases - Computers | | | | | | - |
| 39 | Capital Leases - Software | 4,432 | 4,432 | 100.00% | 4,432 | 100.00% | 4,432 |
| 40 | Capital Leases - Other | 685 | 685 | 100.00% | 685 | 100.00% | 685 |
| 41 | Leaseholds - Buildings | 32,889 | 32,741 | 100.00% | 32,741 | 100.00% | 32,741 |
| 42 | Leaseholds - Computers | | | | | | - |
| 43 | Intangibles - Software | 106,880 | 270,377 | 100.00% | 270,377 | 100.00% | 270,377 |
| 44 | Intangibles - Spectrum Rights | 29 | 29 | 100.00% | 29 | 100.00% | 29 |
| 45 | Total Plant in Service | 6,736,354 | 8,321,020 | 56.15% | 4,672,478 | | 4,467,740 |
| 46 | (L.1 thru 26)-L10 | | | | | | |
| 47 | | | | | | | |
| 48 | Reproduction Cost New Factor | 1.235 | | | | | |
| 49 | (Original Cost Plant / RCN Plant) | | | | | | |
| 50 | | | | | | | |
| 51 | Arizona Intrastate Operations | | | | | | |
| 52 | Intrastate Ratio | 72.20% | 72.20% | | 72.20% | Schedule F | 71.22% |
| 53 | Intrastate Plant in Service | 4,863,469 | 6,007,556 | | 3,373,405 | | 3,181,844 |
| 54 | RCND Adjustment Due to Percent Condition | | | | | | (191,561) |
| 55 | 50% Weighting Factor | | | | | | 50% |
| 56 | Fair Value Adjustment Due To Percent Condition | | | | | | (95,780) |

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
SUMMARY OF JURISDICTIONAL RATE BASE
TEST YEAR ENDING 12/31/2003
(000's)



| Line No. | Description | Qwest Pro Forma Test Year | ACC Adjustments | ACC Proposed |
|---|---|---|---|---|
| | (A) | (B) | (C) | (D) |
| 1 | Telephone Plant In Service | $ 4,750,352 | $ (76,252) | $ 4,674,100 |
| 2 | Short-Term Plant Under Construction | 21,448 | (21,448) | - |
| 3 | Materials and Supplies | 7,255 | (2,393) | 4,862 |
| 4 | Allowance for Cash Working Capital | (52,173) | (10,717) | (62,890) |
| 5 | Accumulated Depr & Amort Reserve | (2,924,497) | (44,372) | (2,968,869) |
| 6 | Accumulated Deferred Income Tax | (251,439) | 72,414 | (179,025) |
| 7 | Customer Deposits | (3,299) | 7 | (3,292) |
| 8 | Land Development Agreement Deposits | (2,023) | 4 | (2,019) |
| 9 | Other Assets & Liabilities | 97,377 | (296) | 97,081 |
| 10 | **End-Of-Period Rate Base** | $ 1,643,001 (a) | $ (83,052) | $ 1,559,949 (b) |

**FOOTNOTES:**

**(a)** Source: Qwest Schedule B-1, Rule 103 filing -- 6/21/04 update.
**(b)** ACC Staff Schedule B, page 2 of 2.

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
SUMMARY OF OUCC RATE BASE ADJUSTMENTS
TEST YEAR ENDING 12/31/2003
(000's)



| Line No. | Description | ADJUSTMENT NUMBER / SCHEDULE REFERENCE | | | | | | | TOTAL |
|---|---|---|---|---|---|---|---|---|---|
| | | B-1 | B-2 | B-3 | B-4 | B-5 | B-6 | B-7 | |
| | (A) | (B) | (C) | (D) | (E) | (F) | (G) | (H) | (I) |
| 1 | Telephone Plant In Service | $ 128,947 | | $ (58,637) | $ (31,017) | $ 1,047 | $ (146,657) | | $ (106,317) |
| 2 | Short-Term Plant Under Construction | (507) | | | | (20,941) | | | (21,448) |
| 3 | Materials and Supplies | (2,226) | | | | | | | (2,226) |
| 4 | Allowance for Cash Working Capital | - | (10,717) | | | | | | (10,717) |
| 5 | Accumulated Depr & Amort Reserve | (58,884) | | 25,607 | 4,395 | (71) | 68,633 | (103,700) | (64,020) |
| 6 | Accumulated Deferred Income Tax | (23,958) | | | | (101) | 30,889 | 40,686 | 47,516 |
| 7 | Customer Deposits | 7 | | | | | | | 7 |
| 8 | Land Development Agreement Deposits | 4 | | | | | | | 4 |
| 9 | Other Assets & Liabilities | (296) | | | | | | | (296) |
| 10 | **End-Of-Period Rate Base** | $ 43,087 | $ (10,717) | $ (33,031) | $ (26,622) | $ (20,066) | $ (47,135) | $ (63,014) | $ (157,497) |

**ADJUSTMENTS:**

**B-1** QWEST UPDATE - CORRECTIONS & REVISIONS
**B-2** CASH WORKING CAPITAL
**B-3** DSL -- REMOVED FROM INTRASTATE
**B-4** BSI -- CONSTRUCTION RELATED CHARGES
**B-5** TELEPHONE PLANT UNDER CONSTRUCTION (TPUC)
**B-6** SOP 98-1 (INTERNAL-USE-SOFTWARE)
**B-7** DEPRECIATION RESERVE CORRECTION

Witness: S. Carver



QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
SUMMARY OF OUCC RATE BASE ADJUSTMENTS
TEST YEAR ENDING 12/31/2003
(000's)

| Line No. | Description | Prior Page Subtotal | ADJUSTMENT NUMBER / SCHEDULE REFERENCE | | | | | | | TOTAL |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | B-8 | B-9 | B-10 | B-11 | B-12 | B-13 | B-14 | |
| | (A) | (B) | (C) | (D) | (E) | (F) | (G) | (H) | (I) | (J) |
| 1 | Telephone Plant In Service | $ (106,317) | $ 55,921 | $ (26,195) | $ 340 | | | | | $ (76,252) |
| 2 | Short-Term Plant Under Construction | (21,448) | | | - | | | | | (21,448) |
| 3 | Materials and Supplies | (2,226) | | (121) | (46) | | | | | (2,393) |
| 4 | Allowance for Cash Working Capital | (10,717) | | | - | | | | | (10,717) |
| 5 | Accumulated Depr & Amort Reserve | (64,020) | (300) | 19,878 | 70 | | | | | (44,372) |
| 6 | Accumulated Deferred Income Tax | 47,516 | 23,112 | 1,816 | (30) | | | | | 72,414 |
| 7 | Customer Deposits | 7 | | - | - | | | | | 7 |
| 8 | Land Development Agreement Deposits | 4 | | | - | | | | | 4 |
| 9 | Other Assets & Liabilities | (296) | | | - | | | | | (296) |
| 10 | **End-Of-Period Rate Base** | $ (157,497) | $ 78,732 | $ (4,622) | $ 335 | $ - | $ - | $ - | $ - | $ (83,052) |

**ADJUSTMENTS:**

**B-8** FAS106 OPEB COSTS
**B-9** VOICE MESSAGING -- STATE DEREGULATED SERVICE
**B-10** FCC DEREGULATED SERVICES -- SEPARATIONS ADJUSTMENT
**B-11** B-11
**B-12** B-12
**B-13** B-13
**B-14** B-14

Witness: Brosch/Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
QWEST UPDATE - CORRECTIONS & REVISIONS
TEST YEAR ENDING 12/31/2003
(000's)

Schedule B-1
Page 1 of 1

**CONFIDENTIAL**

| Line No. | Description (A) | Reference (B) | Qwest Revised Intrastate UTI 1-1S1 Amount (C) | Qwest Filing Intrastate 6/21/04 Update Amount (D) | Difference Adjustment (E) | Rate Base Total of Qwest Correction Adjustment (F) |
|---|---|---|---|---|---|---|
| 1 | **Qwest Proposed Corrections & Revisions** | | | | | |
| 2 | **PFR-04 Cash Working Capital - Exclude Noncash Expenses** | UTI 2-13 | [redacted] | | | |
| 3 | **PFA-03 SOP 98-01 Software Accounting** | | | | | |
| 4 | Plant in Service | UTI 1-01S1 | | | | |
| 5 | Accumulated Deprec/Amort Reserve | | | | | |
| 6 | Net Plant | | | | | |
| 7 | Deferred Income Taxes | | | | | |
| 8 | Rate Base Impact | | | | | |
| 9 | **PFA-04 Telephone Plant Under Construction** | | | | | |
| 10 | Plant in Service | | | | | |
| 11 | Short Term TPUC | | | | | |
| 12 | Accumulated Deprec/Amort Reserve | | | | | |
| 13 | Net Plant | | | | | |
| 14 | Deferred Income Taxes | | | | | |
| 15 | Rate Base Impact | | | | | |
| 16 | **PFA-02 Post Employment Benefits Other Than Pensions** | | | | | |
| 17 | Plant in Service | | | | | |
| 18 | Accumulated Deprec/Amort Reserve | | | | | |
| 19 | Net Plant | | | | | |
| 20 | Deferred Income Taxes | | | | | |
| 21 | Rate Base Impact | | | | | |
| 22 | **PFN-01 Out of Period Adjustment Correction - Materials & Supplies (only)** | | | | | |
| 23 | **PFN-12 Planning for Enhanced Services (FCC Dereg)** | | | | | |
| 24 | Plant in Service | | | | | |
| 25 | Materials & Supplies | | | | | |
| 26 | Accumulated Deprec/Amort Reserve | | | | | |
| 27 | Net Plant | | | | | |
| 28 | Deferred Income Taxes | | | | | |
| 29 | Rate Base Impact | | | | | |
| 30 | **PFN-14 Separations Changes from PFN-12** | | | | | |
| 31 | Plant in Service | | | | | |
| 32 | Short Term TPUC | | | | | |
| 33 | Materials & Supplies | | | | | |
| 34 | Accumulated Deprec/Amort Reserve | | | | | |
| 35 | Net Plant | | | | | |
| 36 | Deferred Income Taxes | | | | | |
| 37 | Customer Deposits | | | | | |
| 38 | Other Assets & Liabilities | | | | | |
| 39 | Rate Base Impact | | | | | |
| 40 | **PFN-17 Separations Update / corrections** | | | | | |
| 41 | Plant in Service | | | | | |
| 42 | Short Term TPUC | | | | | |
| 43 | Materials & Supplies | | | | | |
| 44 | Accumulated Deprec/Amort Reserve | | | | | |
| 45 | Net Plant | | | | | |
| 46 | Deferred Income Taxes | | | | | |
| 47 | Customer Deposits | | | | | |
| 48 | Land Development Agreements | | | | | |
| 49 | Rate Base Impact | | | | | |
| 50 | **TOTAL OF QWEST CORRECTIONS & REVISIONS TO RATE BASE** | | | | | $ 43,087 |

**Sources:** Qwest's Schedule C-2, June 21, 2004 update, & Qwest's response to Staff Data Requests UTI 1-1S1 & UTI 7-2S1.

Witness: M. Brosch

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
CASH WORKING CAPITAL
TEST YEAR ENDING 12/31/2003
(000's)

Schedule B-2
Page 1 of 1

**CONFIDENTIAL**

| Line No. | Description | Adjusted Amount (Sch. C) | Avg Daily Amount (Col C/365) | Revenue Lag Days Qwest PFR-04 | Expense Lag Days (Footnotes) | Net Lag Days (Col D - E) | Cash Working Capital (Col F * E) |
|---|---|---|---|---|---|---|---|
| | (A) | (B) | (C) | (D) | (E) | (F) | (G) |
| 1 | OPERATING EXPENSES | Note 3 | | | | | |
| 2 | Maintenance Expense | [redacted] | | | | | |
| 3 | Engineering Expense | | | | | | |
| 4 | Network Operations Expense | | | | | | |
| 5 | Network Administration Expense | | | | | | |
| 6 | Access Expense | | | | | | |
| 7 | Other Expense | | | | | | |
| 8 | Total Cost of Services & Products | | | | | | |
| 9 | Customer Operations Expense | | | | | | |
| 10 | Corporate Operations Expense | | | | | | |
| 11 | Property Taxes | | | | | | |
| 12 | Other Taxes (Excluding Income Taxes) | | | | | | |
| 13 | Uncollectibles | | | | | | |
| 14 | Total Selling, General and Administrative | | | | | | |
| 15 | Current Federal Income Tax | | | | | | |
| 16 | Current State Income Tax | | | | | | |
| 17 | Total Current Income Taxes | | | | | | |
| 18 | OTHER CASH TRANSACTIONS | | | | | | |
| 19 | Federal Excise Taxes | | | | | | |
| 20 | Flow-Through Taxes | | | | | | |
| 21 | Other Accrued Liabilities | | | | | | |
| 22 | Interest Expense (Sch. C-21) | | | | | | |
| 23 | TOTAL CASH WORKING CAPITAL REQUIREMENT (L18+L23) | | | | | | (62,890) |
| 24 | Less: Qwest Revised Cash Working Capital (UTI 2-13) | | | | | | (52,173) |
| 25 | Staff Adjustment to Cash Working Capital (Line 23 - Line 24) | | | | | | $ (10,717) |

**FOOTNOTES:**

**(1)** Lag day values in Column E for lines 2,3,4,5,7, 9 and 10 are impacted by Staff's revisions to embedded wage and benefit lag day calculations, as explained in testimony of Staff witness Brosch.

**(2)** Interest expense lag day at line 22, column E is revised to eliminated non-cash amortization of debt expenses, as explained in the testimony of Staff witness Brosch.

**(3)** Income statement input amounts in Column C are from Schedule C, except for Interest from Schedule C-21, Federal Excise and Flow through taxes, which are Qwest-proposed amounts, and current Federal and State income taxes, which are derived as follows:

| | Per Books Qwest E-8 Detail | Total Staff Sch.C Adjustments | Staff Adjusted Current FIT/SIT |
|---|---|---|---|
| 7220 FIT Current | (29,585) | 85,260 | 55,675 |
| 7230 SIT & LIT | (6,053) | 19,107 | 13,054 |

Witness: Carver/Dunkel

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
DSL -- REMOVED FROM INTRASTATE
TEST YEAR ENDING 12/31/2003
(000's)



**CONFIDENTIAL**

| Line No. | Description | Reference | Intrastate As Recorded | ACC Staff DSL Adjustment |
|---|---|---|---|---|
| | (A) | (B) | (C) | (D) |
| [redacted] | | | | |
| | ACC Staff Adjustment to Assign Test Year DSL Net Investment to Interstate Operations | | | $ (33,031) |

**FOOTNOTES:**
**(a)** Source: ACC Staff witness Dunkel, Schedule WDA-15 & Workpaper B-3.

Witness: Carver/Dunkel

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
BSI -- CONSTRUCTION RELATED CHARGES
TEST YEAR ENDING 12/31/2003
(000's)



**CONFIDENTIAL**

| Line No. | Description | Reference | Intrastate As Recorded | ACC Staff BSI Adjustment |
|---|---|---|---|---|
| | (A) | (B) | (C) | (D) |
| [redacted] | | | | |
| | ACC Staff Adjustment to Remove Test Year Net Investment Related to BSI Construction Charges | | | $ (26,622) |

**FOOTNOTES:**

**(a)** Source: ACC Staff witness Dunkel, Schedule WDA-18 & Workpaper B-4.

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
TELEPHONE PLANT UNDER CONSTRUCTION (TPUC)
TEST YEAR ENDING 12/31/2003
(000's)



| Line No. | Description | Reference | Intrastate Amount |
|---|---|---|---|
| | (A) | (B) | (C) |
| 1 | Qwest Proposed TPUC Rate Base Allowance | (a) | |
| 2 | Telephone Plant In Service | (b) | $ (1,047) |
| 3 | Telephone Plant Under Construction | (b)(c) | 20,941 |
| 4 | Accumulated Depreciation & Amort. Reserve | (b) | 71 |
| 5 | Accumulated Deferred Income Tax | (b) | 101 |
| 6 | Net Rate Base Effect | | $ 20,066 |
| 7 | ACC Staff Adjustment to Remove TPUC From Rate Base and Continue Arizona's Capitalization Method | | $ (20,066) |

**FOOTNOTES:**

**(a)** Qwest proposed to depart from the ACC's capitalization method and adopt the FCC's Revenue Requirement Offset Method.

**(b)** Source: Qwest response to Staff Data Request UTI 1-1S1, Attachment A, Adjustment PFA-04.

**(c)** Telephone Plant Under Construction

| | |
|---|---|
| Qwest PFA-04 | $ 21,023 |
| Qwest PFN-14, TPUC (Staff Adjustment B-1) | (43) |
| Qwest PFN-17, TPUC (Staff Adjustment B-1) | (39) |
| Total TPUC Adjustment | $ 20,941 |

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
SOP 98-1 (INTERNAL-USE-SOFTWARE)
TEST YEAR ENDING 12/31/2003
(000's)



| Line No. | Description | Reference | Revised Qwest Adjustment PFA-03 | ACC Staff Reversal |
|---|---|---|---|---|
| | (A) | (B) | (C) | (D) |
| 1 | Qwest Proposed SOP 98-1 Adjustment | (a) | | |
| 2 | Telephone Plant In Service | (b) | $ 146,657 | $ (146,657) |
| 3 | Accumulated Depreciation & Amort. Reserve | (b) | (68,633) | 68,633 |
| 4 | Accumulated Deferred Income Tax | (b) | (30,889) | 30,889 |
| 5 | Net Rate Base Effect | | $ 47,135 | |
| 6 | ACC Staff Adjustment to Reverse Qwest's Retroactive Adoption of SOP 98-1 in 1999 and Reflect Prospective Capitalization & Amortization for Arizona Regulatory Purposes | | | $ (47,135) |

**FOOTNOTES:**

**(a)** In its original filing, Qwest proposed to first recognize the pro forma effect of SOP 98-1 for regulatory purposes in the current rate case. Subsequently in response to Staff Data Request UTI 4-2, Qwest revised its recommendation to retroactively adopt SOP 98-1 for Arizona regulatory purposes effective January 1, 1999.

**(b)** Source: Qwest response to Staff Data Request UTI 4-1 S1 & revised Adjustment PFA-03. Also, see the revised response to Staff Data Request UTI 1-1S1.

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
DEPRECIATION RESERVE CORRECTION
TEST YEAR ENDING 12/31/2003
(000's)



| Line No. | Description | Reference | QWEST PROPOSED ADJUSTMENTS: Depreciation PFA-01 | QWEST PROPOSED ADJUSTMENTS: Depreciation Synchronization PFN-11 | QWEST PROPOSED ADJUSTMENTS: Total | ACC Staff Reversal |
|---|---|---|---|---|---|---|
| | (A) | (B) | (C) | (D) | (E) | (F) |
| 1 | Accumulated Depreciation & Amortization Reserve | | $ 109,701 | $ (6,001) | $ 103,700 | $ (103,700) |
| 2 | Accumulated Deferred Income Tax Reserve | | (43,040) | 2,354 | (40,686) | 40,686 |
| 3 | Net Rate Base Effect | Line 1 + 2 | $ 66,661 (a) | $ (3,647) (b) | $ 63,014 | |
| 4 | ACC Staff Adjustment to Reverse the Effects of Qwest's Pro Forma Adjustment to Rate Base For the Change in Book Depreciation Expense | | | | | $ (63,014) |

**FOOTNOTES:**

**(a)** Source: Qwest Schedule B-2 (p. 4), Adjustment PFA-01, Rule 103 filing -- 6/21/04 update.

**(b)** Source: Qwest Schedules B-2 (p. 3), Adjustment PFN-11, Rule 103 filing -- 6/21/04 update.

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
FAS106 OPEB COSTS
TEST YEAR ENDING 12/31/2003
(000'S)



**CONFIDENTIAL**

| Line No. | Description | Reference | Qwest Adjustment PFA-02 | ACC Staff Proposed | ACC Staff OPEB Adjustment |
|---|---|---|---|---|---|
| | (A) | (B) | (C) | (D) | (E) |
| 1 | OPEB Rate Base Allowance | | | | |
| 2 | Telephone Plant In Service | Qwest PFA-02 | $ (120,371) | $ (64,450) | $ 55,921 |
| 3 | Accumulated Depreciation Reserve | | 300 | | (300) |
| 4 | Accumulated Deferred Income Tax | Qwest PFA-02 | 2,365 | 25,477 | 23,112 |
| 5 | Net Rate Base Effect | Line 1 + Line 2 | $ (117,706) (g) | $ (38,974) (a) | |
| 6 | ACC Staff Adjustment to Reflect Rate Base Offset for Unfunded FAS106 OPEB Costs in Excess of PAYGO Levels | | | | $ 78,732 |

**FOOTNOTES:**

(a) Staff Proposed Unfunded OPEB Costs -- Medical & Life (intrastate)

| | | 1999 | 2000 | 2001 | 2002 | 2003 | Accrual - PAYGO Cumulative |
|---|---|---|---|---|---|---|---|
| Service Cost | | [redacted] | | | | | |
| Interest Cost | | | | | | | |
| Expected Return | | | | | | | |
| Amort. Of Prior Service Cost | | | | | | | |
| Amort. Of Actuarial Gain | | | | | | | |
| Subtotal | (b)(d)(e) | | | | | | |
| TBO Amortization | (b)(c) | | | | | | |
| Total Medical & Life Accrual | | | | | | | |
| Less: PAYGO | (d)(e)(f) | | | | | | |
| Unfunded FAS106 | | | | | | | $ 64,450,468 |
| | | (b)(f) | (d) | (e) | (e) | (e) | |
| Deferred Income Tax Reserve | | | | | | | |
| Fed. & State Inc. Tax Rate | | 39.5292% | | | | | (25,476,754) |
| Staff Proposed Unfunded OPEB Rate Base Allowance | | | | | | | $ 38,973,714 |

(b) Source: Qwest response to Staff Data Request UTI 47-11, Confidential Attachment B (Docket No. T-1051B-99-105).

(c) TBO Amortization fixed at amount recognized in Docket No. T-1051B-99-105.

(d) Source: 2000 data per Qwest response to Staff Data Request UTI 20-5, confidential Attachment A.

(e) Source: 2001-2003 data per Qwest response to Staff Data Request UTI 18-9, Confidential Attachments A, B & C.

(f) Source: 1999 PAYGO amount per Qwest responses to Staff Data Request UTI 47-11 (Confidential Attachment B) & UTI 47-12(b), Docket No. T-1051B-99-105.

(g) Source: Qwest response to Staff Data Request UTI 1-1S1, Attachment A, Adjustment PFA-02.

| Witness: S. Carver | QWEST CORPORATION<br>DOCKET NO. T-01051B-03-0454<br>VOICE MESSAGING -- STATE DEREGULATED SERVICE<br>TEST YEAR ENDING 12/31/2003<br>(000's) | Schedule B-9<br>Page 1 of 1 |
|---|---|---|

**CONFIDENTIAL**

| Line No. | Description | "Corrected" Voice Messaging (State Dereg) | Staff Adjustment Removing Voice Messaging |
|---|---|---|---|
| | (A) | (B) | (C) |
| [redacted] | | | |
| | ACC Staff Adjustment to Remove From Rate Base the Net Investment for Deregulated Voice Messaging Services Consistent with Staff's Recommendation | | $ (4,622) |

**FOOTNOTES:**

**(a)** Source: Staff Workpaper C-19 & Qwest confidential response to Staff Data Request UTI 9-9, Attachment B -- corrected for Planning for Enhanced Services.

Witness: S. Carver



QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
FCC DEREGULATED SERVICES -- SEPARATIONS ADJUSTMENT
TEST YEAR ENDING 12/31/2003
(000's)

| Line No. | Description | Intrastate Adjustments: Qwest PFA | Intrastate Adjustments: Qwest PFN (excl. sep. adj.) | Intrastate Adjustments: Qwest PFR | Intrastate Adjustments: Total Qwest Adjustments (excl. sep. adj.) | Intrastate Adjustments: Staff Adjustments (excl. sep. adj.) | Total Qwest & Staff Adjustments | %Intrastate Net Change Ratio (c) | Effect of Separations Factor Changes | FCC Dereg 50% Imputation |
|---|---|---|---|---|---|---|---|---|---|---|
| | (A) | (B) | (C) | (D) | (E) | (F) | (G) | (H) | (I) | (J) |
| 1 | Telephone Plant In Service | $ 25,239 | $ 1,288 | | $ 26,527 | $ (76,591) | $ (50,064) | -1.3563% | $ 679 | $ 340 |
| 2 | Short-Term Plant Under Construction (d) | | - | | - | (21,448) | (21,448) | | - | - |
| 3 | Materials and Supplies | 21,023 | (13,344) | | 7,679 | (2,347) | 5,332 | -1.7110% | (91) | (46) |
| 4 | Cash Working Capital | | | $ (52,173) | (52,173) | (10,717) | (62,890) | | - | - |
| 5 | Accumulated Depr & Amort Reserve | 41,439 | (7,301) | | 34,138 | (44,443) | (10,305) | -1.3670% | 141 | 70 |
| 6 | Accumulated Deferred Income Tax | (71,463) | 2,400 | | (69,063) | 72,444 | 3,381 | -1.7587% | (59) | (30) |
| 7 | Customer Deposits | | - | (891) | (891) | 7 | (884) | 0.0000% | - | - |
| 8 | Land Development Agreement | | - | | - | 4 | 4 | 0.0000% | - | - |
| 9 | Other Assets & Liabilities | | - | 97,377 | 97,377 | (296) | 97,081 | 0.0000% | - | - |
| 10 | **End-Of-Period Rate Base** | $ 16,238 | $ (16,957) | $ 44,313 | $ 43,594 | $ (83,387) | $ (39,793) | | $ 669 | |
| 11 | ACC Staff Adjustment to Reflect 50% of Separations Correction Associated with FCC Deregulated Services | | | | | | | | | $ 335 |

**FOOTNOTES:**

**(a)** Source: Qwest response to Staff Data Request UTI 1-1S1, Attachment A, excluding PFN-14 & PFN-17.
**(b)** Source: Staff Schedule C, p. 1, excluding Adjustment C-20.
**(c)** Source: Staff Schedule F, Intrastate Separations Factors.
**(d)** Staff Adjustment B-5 removes TPUC from rate base -- no need to quantify separations impact.

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
SUMMARY OF OPERATING INCOME
TEST YEAR ENDING 12/31/2003



| Line No. | Description | Qwest Pro Forma | ACC Staff Adjustments | ACC Staff Proposed |
|---|---|---|---|---|
| | (A) | (B) | (C) | (D) |
| | **Revenues** | | | |
| 1 | Local Service Revenues | $ 775,134 | $ 5,863 | $ 780,997 |
| 2 | Network Access Service Revenues | 65,547 | 3,221 | 68,768 |
| 3 | LongDistance Network Service Revenues | 8,586 | 1,309 | 9,895 |
| 4 | Miscellaneous | 261,801 | (8,568) | 253,233 |
| 5 | Total Operating Revenues | 1,111,068 | 1,826 | 1,112,894 |
| | **Expenses** | | | |
| 6 | Maintenance | 246,117 | (23,228) | 222,889 |
| 7 | Engineering Expense | 10,519 | (3,141) | 7,378 |
| 8 | Network Operations | 69,967 | (18,730) | 51,237 |
| 9 | Network Administration | 1,681 | (186) | 1,495 |
| 10 | Access Expense | 9,041 | - | 9,041 |
| 11 | Other | 555 | (103) | 452 |
| 12 | Total Cost of Services & Products | 337,880 | (45,388) | 292,492 |
| 13 | Customer Operations | 188,545 | (21,760) | 166,785 |
| 14 | Corporate Operations | 202,806 | (32,263) | 170,543 |
| 15 | Property & Other Taxes | 67,424 | (1,284) | 66,140 |
| 16 | Uncollectibles | 19,634 | (51) | 19,583 |
| 17 | Total Selling, General and Administrative | 478,409 | (55,358) | 423,051 |
| 18 | Other Operating Income & Expense | (44) | 1 | (43) |
| 19 | Depreciation Expense | 364,079 | (152,897) | 211,182 |
| 20 | Universal Service Fund | - | - | - |
| 21 | Link Up America | (2) | - | (2) |
| 22 | Total Operating Expense | 1,180,322 | (253,642) | 926,680 |
| 23 | **Income From Operations** | (69,254) | 255,468 | 186,214 |
| | **Taxes** | | | |
| 24 | Federal Income Tax | (52,028) | 85,260 | 33,232 |
| 25 | State & Local Income Tax | (12,170) | 19,107 | 6,937 |
| 26 | **Net Operating Income** | $ (5,056) | $ 151,100 | $ 146,044 |
| | | (a) | (b) | |

**FOOTNOTES:**

**(a)** Source: Qwest Adjustment PFR-03, workpapers supporting Rule 103 filing -- 6/21/04 update.

**(b)** ACC Staff Schedule C, page 4 of 4.

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
SUMMARY OF OUCC NOI ADJUSTMENTS
TEST YEAR ENDING 12/31/2003
(000's)



| Line No. | Description | | C-1 | C-2 | C-3 | C-4 | C-5 | C-6 | C-7 | C-8 | C-9 | SUBTOTAL |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | ADJUSTMENT NUMBER / SCHEDULE REFERENCE | | | | | | | | | |
| | (A) | | (B) | (C) | (D) | (E) | (F) | (G) | (H) | (I) | (J) | (K) |
| | **Revenues** | | | | | | | | | | | |
| 1 | Local Service Revenues | | $ 1,366 | $ 792 | | | $ 3,705 | | | | | $ 5,863 |
| 2 | Network Access Service Revenues | | 3,353 | | (132) | | | | | | | 3,221 |
| 3 | LongDistance Network Service Revenues | | 233 | | | 1,076 | | | | | | 1,309 |
| 4 | Miscellaneous | | 1,369 | | | | | | | 329 | | 1,698 |
| 5 | Total Operating Revenues | | $ 6,321 | $ 792 | $ (132) | $ 1,076 | $ 3,705 | $ - | $ - | $ 329 | $ - | $ 12,091 |
| | **Expenses** | | | | | | | | | | | |
| 6 | Maintenance | | (3,377) | | | | | $ (2,822) | | | | $ (6,200) |
| 7 | Engineering Expense | | (202) | | | | | | | | | (202) |
| 8 | Network Operations | | (1,701) | | | | | (649) | | | | (2,350) |
| 9 | Network Administration | | (29) | | | | | | | | | (29) |
| 10 | Access Expense | | - | | | | | | | | | - |
| 11 | Other | | (17) | | | | | | | | | (17) |
| 12 | Total Cost of Services & Products | | (5,326) | - | - | - | - | (3,472) | - | - | - | (8,798) |
| 13 | Customer Operations | | 549 | | | | | | | | | 549 |
| 14 | Corporate Operations | | (21,365) | | | | | | | | (5,507) | (26,872) |
| 15 | Property & Other Taxes | | (1,020) | | | | | | | | | (1,020) |
| 16 | Uncollectibles | | 62 | | | | | | | | | 62 |
| 17 | Total Selling, General and Administrative | | (21,774) | - | - | - | - | - | - | - | (5,507) | (27,281) |
| 18 | Other Operating Income & Expense | | - | | | | | | | | | - |
| 19 | Depreciation Expense | | 23,312 | | | | | (5,429) | (2,942) | 71 | | 15,012 |
| 20 | Universal Service Fund | | - | | | | | | | | | - |
| 21 | Link Up America | | - | | | | | | | | | - |
| 22 | Total Operating Expense | | $ (3,789) | $ - | $ - | $ - | $ - | $ (8,901) | $ (2,942) | $ 71 | $ (5,507) | $ (21,067) |
| 23 | **Income From Operations** | | $ 10,110 | $ 792 | $ (132) | $ 1,076 | $ 3,705 | $ 8,901 | $ 2,942 | $ 258 | $ 5,507 | $ 33,158 |
| | **Taxes** | | | | | | | | | | | |
| 24 | Federal Income Tax | 32.5612% | 2,818 | 258 | (43) | 350 | 1,206 | 2,898 | 958 | 84 | 1,793 | 10,323 |
| 25 | State & Local Income Tax | 6.9680% | 1,926 | 55 | (9) | 75 | 258 | 620 | 205 | 18 | 384 | 3,532 |
| 26 | **Net Operating Income** | | $ 5,366 | $ 479 | $ (80) | $ 651 | $ 2,240 | $ 5,382 | $ 1,779 | $ 156 | $ 3,330 | $ 19,304 |

**ADJUSTMENTS:**

- **C-1** QWEST UPDATE - CORRECTIONS & REVISIONS
- **C-2** LOCAL SERVICE REVENUE CORRECTION
- **C-3** ACCESS REVENUE ANNUALIZATION
- **C-4** TOLL REVENUE ANNUALIZATION
- **C-5** DIRECTORY ASSISTANCE REVENUE ANNUALIZATION
- **C-6** DSL – REMOVED FROM INTRASTATE
- **C-7** BSI – CONSTRUCTION RELATED CHARGES
- **C-8** TELEPHONE PLANT UNDER CONSTRUCTION (TPUC)
- **C-9** MARKETING & ADVERTISING COSTS

Witness: S. Carver



QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
SUMMARY OF OUCC NOI ADJUSTMENTS
TEST YEAR ENDING 12/31/2003
(000's)

| Line No. | Description | | Prior Page Subtotal | ADJUSTMENT NUMBER / SCHEDULE REFERENCE | | | | | | | | SUBTOTAL |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | C-10 | C-11 | C-12 | C-13 | C-14 | C-15 | C-16 | C-17 | |
| | (A) | | (B) | (C) | (D) | (E) | (F) | (G) | (H) | (I) | (J) | (K) |
| | **Revenues** | | | | | | | | | | | |
| 1 | Local Service Revenues | | $ 5,863 | | | | | | | | | $ 5,863 |
| 2 | Network Access Service Revenues | | 3,221 | | | | | | | | | 3,221 |
| 3 | LongDistance Network Service Revenues | | 1,309 | | | | | | | | | 1,309 |
| 4 | Miscellaneous | | 1,698 | | | | | | | | | 1,698 |
| 5 | Total Operating Revenues | | $ 12,091 | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ 12,091 |
| | **Expenses** | | | | | | | | | | | |
| 6 | Maintenance | | $ (6,200) | | | | | | | $ (43) | $ (3,244) | $ (9,486) |
| 7 | Engineering Expense | | (202) | | | | | | | (877) | (1,104) | (2,183) |
| 8 | Network Operations | | (2,350) | | | | | | | (8,046) | | (10,397) |
| 9 | Network Administration | | (29) | | | | | | | (16) | | (45) |
| 10 | Access Expense | | - | | | | | | | | | - |
| 11 | Other | | (17) | | | | | | | | | (17) |
| 12 | Total Cost of Services & Products | | (8,798) | - | - | - | - | - | - | (8,982) | (4,348) | (22,128) |
| 13 | Customer Operations | | 549 | | | | | | | (3,309) | (1,227) | (3,988) |
| 14 | Corporate Operations | | (26,872) | (520) | | (1,993) | (1,298) | (381) | (113) | (230) | (146) | (31,553) |
| 15 | Property & Other Taxes | | (1,020) | | | | | | | | | (1,020) |
| 16 | Uncollectibles | | 62 | | | | | | | | | 62 |
| 17 | Total Selling, General and Administrative | | (27,281) | (520) | - | (1,993) | (1,298) | (381) | (113) | (3,540) | (1,373) | (36,499) |
| 18 | Other Operating Income & Expense | | - | | | | | | | | | - |
| 19 | Depreciation Expense | | 15,012 | | (24,468) | | | | | | | (9,456) |
| 20 | Universal Service Fund | | - | | | | | | | | | - |
| 21 | Link Up America | | - | | | | | | | | | - |
| 22 | Total Operating Expense | | $ (21,067) | $ (520) | $ (24,468) | $ (1,993) | $ (1,298) | $ (381) | $ (113) | $ (12,522) | $ (5,722) | $ (68,084) |
| 23 | **Income From Operations** | | $ 33,158 | $ 520 | $ 24,468 | $ 1,993 | $ 1,298 | $ 381 | $ 113 | $ 12,522 | $ 5,722 | $ 80,175 |
| | **Taxes** | | | | | | | | | | | |
| 24 | Federal Income Tax | 32.5612% | 10,323 | 169 | 7,967 | 649 | 423 | 124 | 37 | 4,077 | 1,863 | 25,632 |
| 25 | State & Local Income Tax | 6.9680% | 3,532 | 36 | 1,705 | 139 | 90 | 27 | 8 | 873 | 399 | 6,808 |
| 26 | **Net Operating Income** | | $ 19,304 | $ 314 | $ 14,796 | $ 1,205 | $ 785 | $ 230 | $ 69 | $ 7,572 | $ 3,460 | $ 47,735 |

**ADJUSTMENTS:**
**C-10** QWEST WIRELESS EXCESSIVE PRICES
**C-11** SOP98-1 (INTERNAL-USE-SOFTWARE)
**C-12** RE-AUDIT, D&O INSURANCE & SECURITIES LITI
**C-13** ALLOCATION FACTOR UPDATES
**C-14** PUBLIC AFFAIRS COSTS
**C-15** QWEST SERVICE CORPORATION COST EXCLUSIONS
**C-16** YEAR-END WAGE & SALARY ANNUALIZATION
**C-17** INCENTIVE COMPENSATION

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
SUMMARY OF OUCC NOI ADJUSTMENTS
TEST YEAR ENDING 12/31/2003
(000's)



| Line No. | Description | | Prior Page Subtotal | ADJUSTMENT NUMBER / SCHEDULE REFERENCE C-18 | C-19 | C-20 | C-21 | C-22 | C-23 | C-24 | C-25 | TOTAL |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | (A) | | (B) | (C) | (D) | (E) | (F) | (G) | (H) | (I) | (J) | (K) |
| | **Revenues** | | | | | | | | | | | |
| 1 | Local Service Revenues | | $ 5,863 | | | | | | | | | $ 5,863 |
| 2 | Network Access Service Revenues | | 3,221 | | | | | | | | | 3,221 |
| 3 | LongDistance Network Service Revenues | | 1,309 | | | | | | | | | 1,309 |
| 4 | Miscellaneous | | 1,698 | | 6,589 | | | | | (16,855) | | (8,568) |
| 5 | Total Operating Revenues | | $ 12,091 | $ - | $ 6,589 | $ - | $ - | $ - | $ - | $ (16,855) | $ - | $ 1,826 |
| | **Expenses** | | | | | | | | | | | |
| 6 | Maintenance | | $ (9,486) | $ (12,736) | | $ 1,035 | | | | $ (2,040) | | $ (23,228) |
| 7 | Engineering Expense | | (2,183) | (953) | | 1 | | | | (5) | | (3,141) |
| 8 | Network Operations | | (10,397) | (8,332) | | 309 | | | | (310) | | (18,730) |
| 9 | Network Administration | | (45) | (133) | | (0) | | | | (7) | | (186) |
| 10 | Access Expense | | - | - | | - | | | | | | - |
| 11 | Other | | (17) | (83) | | (0) | | | | (3) | | (103) |
| 12 | Total Cost of Services & Products | | (22,128) | (22,238) | - | 1,344 | - | - | - | (2,366) | - | (45,388) |
| 13 | Customer Operations | | (3,988) | (12,948) | | - | | | | (4,823) | | (21,760) |
| 14 | Corporate Operations | | (31,553) | (657) | | 1,890 | | | | (1,942) | | (32,263) |
| 15 | Property & Other Taxes | | (1,020) | - | 24 | 52 | | | | (339) | | (1,284) |
| 16 | Uncollectibles | | 62 | - | 121 | 13 | | | | (248) | | (51) |
| 17 | Total Selling, General and Administrative | | (36,499) | (13,606) | 145 | 1,955 | - | - | - | (7,353) | - | (55,358) |
| 18 | Other Operating Income & Expense | | - | | | 0 | | | | 0 | | 1 |
| 19 | Depreciation Expense | | (9,456) | | | - | | (54,518) | (85,930) | (2,993) | | (152,897) |
| 20 | Universal Service Fund | | - | | | - | | | | | | - |
| 21 | Link Up America | | - | | | - | | | | | | - |
| 22 | Total Operating Expense | | $ (68,084) | $ (35,843) | $ 145 | $ 3,299 | $ - | $ (54,518) | $ (85,930) | $ (12,712) | $ - | $ (253,642) |
| 23 | **Income From Operations** | | $ 80,175 | $ 35,843 | $ 6,444 | $ (3,299) | $ - | $ 54,518 | $ 85,930 | $ (4,143) | $ - | $ 255,468 |
| | **Taxes** | | | | | | | | | | | |
| 24 | Federal Income Tax | 32.5612% | 25,632 | 11,671 | 2,098 | (1,074) | 2,436 | 17,752 | 27,980 | (1,235) | - | 85,260 |
| 25 | State & Local Income Tax | 6.9680% | 6,808 | 2,498 | 449 | (230) | 521 | 3,799 | 5,988 | (725) | - | 19,107 |
| 26 | **Net Operating Income** | | $ 47,735 | $ 21,675 | $ 3,897 | $ (1,995) | $ (2,957) | $ 32,968 | $ 51,962 | $ (2,184) | $ - | $ 151,100 |

**ADJUSTMENTS:**
**C-18** FAS106 OPEB COSTS
**C-19** FCC DEREGULATED SERVICES -- REVENUE IM
**C-20** FCC DEREGULATED SERVICES -- SEPARATION
**C-21** INTEREST SYNCHRONIZATION
**C-22** DEPRECIATION ANNUALIZATION - 12/31/03 RESERVE UPDATE
**C-23** DEPRECIATION ANNUALIZATION - STAFF PROPOSED RATES
**C-24** VOICE MESSAGING -- STATE DEREGULATED SERVICE
**C-25** **reserved**

Witness: Brosch/Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
QWEST UPDATE - CORRECTIONS & REVISIONS
TEST YEAR ENDING 12/31/2003
$000



**CONFIDENTIAL**

| Line No. | Description | | Reference | Qwest Revised Intrastate UTI 1-1S1 Amount | Qwest Filing Intrastate 6/21/04 Update Amount | Difference Adjustment | Operating Income Impact of Qwest Correction Adjustments |
|---|---|---|---|---|---|---|---|
| | (A) | | (B) | (C) | (D) | (E) | (F) |
| 1 | **Qwest Proposed Corrections & Revisions** | | | | | | |
| 2 | **Revenue Trending PFN-03 Revisions** | | | | | | |
| 3 | Local Service Recurring | | UTI 2-06, 7-02 | [redacted] | | | |
| 4 | Non-Recurring | | " | | | | |
| 5 | Directory Assistance Revenues | | " | | | | |
| 6 | Access Revenues | | " | | | | |
| 7 | Toll Revenues | | " | | | | |
| 8 | Miscellaneous White Pages | | " | | | | |
| 9 | Wholesale | | " | | | | |
| 10 | Late Payment Fee | | " | | | | |
| 11 | Billing and Collection | | " | | | | |
| 12 | FCC Nonregulated Revenues | | " | | | | |
| 13 | **Total Revision to Qwest Revenue Trending Adjustments** | | | | | | |
| 14 | **Out of Period PFN-01 Revisions** | | | | | | |
| 15 | Local Service Revenue | | Various Staff | | | | |
| 16 | Access Revenues | | Data Requests | | | | |
| 17 | Toll Revenues | | Including: | | | | |
| 18 | Miscellaneous | | UTI 3-36, 4-31, | | | | |
| 19 | FCC Nonregulated Revenues | | 4-23, 7-2, 12-18, | | | | |
| 20 | Total Revenue Amount | | UTI 13-12, 14-01 | | | | |
| 21 | | | WDA 17-2, 10C-18 | | | | |
| 22 | Maintenance Expense | | | | | | |
| 23 | Corporation Operations Expense | | | | | | |
| 24 | Total Expense Amount | | | | | | |
| 25 | **Rent Compensation PFN-07 Revision** | Misc. Rev/Exp | UTI 3-16S1 | | | | |
| 26 | **Property Tax True-up PFN-10** | Taxes Other | UTI 4-06c | | | | |
| 27 | **Planning for Enhanced FCC Dereg PFN-12** | Expenses | UTI 9-08A, 15-7a | | | | |
| 28 | **Eliminate Contingency Accruals PFN-13** | Rev / Expense | UTI 3-23, 7-16, 19-3 | | | | |
| 29 | **Revised Separations Factors PFN-14** | Rev / Expense | UTI 9-08A, 15-07b | | | | |
| 30 | **SOP 98-01 1999 Adoption PFA-03** | Depreciation | UTI 4-02 | | | | |
| 31 | **Charitable Contributions Elimination PFR-07** | Corporate Ops | UTI 8-25 | | | | |
| 32 | **Plant Under Contruction PFA-04** | Revenue | UTI 1-01S1 | | | | |
| 34 | **Other Post Emp, Benefits OPEB PFA-02** | Expenses | RUCO 3-10 | | | | |
| 35 | **Sponsorships Elimination PFN-16** | Expenses | UTI 15-24A | | | | |
| 36 | **Effective Income Tax Rate Correction PFN-15** | Income Tax | UTI 15-18, 18-10 | | | | |
| 37 | **Interest Synchronization PFR-03** | Income Tax | | | | | |
| 38 | **Revised Separations Factors PFN-17** | Rev / Expense | WDA 14-6, 18-2, 18-3 | | | | |
| 39 | **Total Operating Income Adjustment to Reflect Qwest Corrections and Revisions** | | | | | | **$ 5,366** |

**Sources:** Qwest's Schedule C-2, June 21, 2004 update, & Qwest's response to Staff Data Requests UTI 1-1S1 & UTI 7-2S1.

Witness: Brosch/Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
QWEST UPDATE - CORRECTIONS & REVISIONS
TEST YEAR ENDING 12/31/2003

Schedule C-1
Page 2 of 2

**CONFIDENTIAL**

Qwest Proposed Corrections & Revisions

| LINE NO. | DESCRIPTION | Revenue Trending PFN-03 | Out of Period Incremental Adj. PFN-01 | Rent Comp. Update Adj. PFN-07 | Property Tax True-up PFN-10 | Planning for Enhanced FCC PFN-12 | Elimination of Contingency $ PFN-13 | Separations Effect of PFN-12 PFN-14 | SOP 98-01 1999 Adoption PFA-03 | Charitable Contributions PFR-07 | Plant Under Construction PFA-04 | Post Employment Benefits OPEB PFA-02 | Sponsorship Elimination PFN-16 | Effective Income Tax Rate Correc. PFN-15 | Interest Synchronization PFR-03 | FCC Separations Compliance Adj PFN-17 | Total of Qwest Corrections & Revisions |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | (A) | (B) | (C) | (D) | (E) | (F) | (G) | (H) | (I) | (J) | (K) | (L) | (M) | (N) | (O) | (P) | (Q) |
| | **Revenues** | [redacted] | | | | | | | | | | | | | | | |
| 1 | Local Service Revenues | | | | | | | | | | | | | | | | $ 1,366 |
| 2 | Network Access Service Revenues | | | | | | | | | | | | | | | | 3,353 |
| 3 | LongDistance Network Service Revenues | | | | | | | | | | | | | | | | 233 |
| 4 | Miscellaneous | | | | | | | | | | | | | | | | 1,369 |
| 5 | Total Operating Revenues | | | | | | | | | | | | | | | | $ 6,321 |
| | **Expenses** | | | | | | | | | | | | | | | | |
| 6 | Maintenance | | | | | | | | | | | | | | | | (3,377) |
| 7 | Engineering Expense | | | | | | | | | | | | | | | | (202) |
| 8 | Network Operations | | | | | | | | | | | | | | | | (1,701) |
| 9 | Network Administration | | | | | | | | | | | | | | | | (29) |
| 10 | Access Expense | | | | | | | | | | | | | | | | - |
| 11 | Other | | | | | | | | | | | | | | | | (17) |
| 12 | Total Cost of Services & Products | | | | | | | | | | | | | | | | (5,326) |
| 13 | Customer Operations | | | | | | | | | | | | | | | | 549 |
| 14 | Corporate Operations | | | | | | | | | | | | | | | | (21,365) |
| 15 | Property & Other Taxes | | | | | | | | | | | | | | | | (1,020) |
| 16 | Uncollectibles | | | | | | | | | | | | | | | | 62 |
| 17 | Total Selling, General and Administrative | | | | | | | | | | | | | | | | (21,774) |
| 18 | Other Operating Income & Expense | | | | | | | | | | | | | | | | - |
| 19 | Depreciation Expense | | | | | | | | | | | | | | | | 23,312 |
| 20 | Universal Service Fund | | | | | | | | | | | | | | | | - |
| 21 | Link Up America | | | | | | | | | | | | | | | | - |
| 22 | Total Operating Expense | | | | | | | | | | | | | | | | $ (3,789) |
| 23 | **Income From Operations** | | | | | | | | | | | | | | | | $ 10,110 |
| | **Taxes** rate below are Qwest Err % | | | | | | | | | | | | | | | | |
| 24 | Federal Income 1 32.7201% | | | | | | | | | | | | | | | | 2,818 |
| 25 | State & Local Inc 6.5141% | | | | | | | | | | | | | | | | 1,926 |
| 26 | **Net Operating Income** | $ 287 | $ 4,738 | $ 309 | $ 1,356 | $ 4,871 | $ 3,544 | $ (551) | $ (14,434) | $ 92 | $ (257) | $ 4,113 | $ 291 | $ (95) | $ 555 | $ 546 | $ 5,366 |

**Sources:** Qwest's Schedule C-2, June 21, 2004 update, & Qwest's response to Staff Data Requests UTI 1-1S1 & UTI 7-2S1.

Witness: M. Brosch

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
LOCAL SERVICE REVENUE CORRECTION
TEST YEAR ENDING 12/31/2003
(000's)

Schedule C-2
Page 1 of 1

**CONFIDENTIAL**

| Line No. | Description | Reference | Intrastate Amount |
|---|---|---|---|
| | (A) | (B) | (C) |
| [redacted] | | | |
| | Staff Adjustment to Correct Local Service Revenues | | $ 792 |

Witness: M. Brosch

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
ACCESS REVENUE ANNUALIZATION
TEST YEAR ENDING 12/31/2003
(000's)

Schedule C-3
Page 1 of 1

**CONFIDENTIAL**

| Line No. | Description | Reference | October Amount | November Amount | December Amount | Total Amount |
|---|---|---|---|---|---|---|
| | (A) | (B) | (C) | (D) | (E) | (F) |
| 1 | Recorded Intrastate Access Revenues | JR4C Report | [redacted] | | | |
| 2 | Less: Jan 2004 Out of Period | UTI 2-06 | | | | |
| 3 | Restatement Adjustments | | | | | |
| 4 | Normalized Recorded Access Revenues | Lines 1..3 | | | | |
| 5 | Times 4 to Annualize (Staff Method) | | | | | times 4 |
| 6 | Staff Proposed Annualized State Access Revenues | | | | | [redacted] |
| 7 | Less: Post Test Period Access Rate Reduction | | | | | 5,000 |
| 8 | Staff Proposed Annualized State Access Revenues at Present Rates | | | | | [redacted] |
| 9 | Qwest Proposed Test Year State Access Revenues (Per UTI 1-1S1, Att. A) | | | | | [redacted] |
| 10 | Staff Adjustment to Annualize Test Year Access Revenues | | | | | $ (132) |

Witness: M. Brosch

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
TOLL REVENUE ANNUALIZATION
TEST YEAR ENDING 12/31/2003
(000's)



**CONFIDENTIAL**

| Line No. | Description | Reference | October Amount | November Amount | December Amount | Total Amount |
|---|---|---|---|---|---|---|
| | (A) | (B) | (C) | (D) | (E) | (F) |
| 1 | **Recorded Intrastate Long Distance Revenues:** | | | | | |
| 2 | 5100.21 Message Toll - Business | UTI 2-06 WPs | [redacted] | | | |
| 3 | 5100.22 Message Toll - Residence | " | | | | |
| 4 | 5100.23..29 Message Other | " | | | | |
| 5 | 5100.41 Toll Calling Plans - Business | " | | | | |
| 6 | 5100.42 Toll Calling Plans - Residence | " | | | | |
| 7 | 5111.2, 4, .52 Inward WATS | " | | | | |
| 8 | 5112.2, 4, .52 Outward WATS | " | | | | |
| 9 | Sum of Analyzed Toll Revenue Accounts | " | | | | |
| 10 | Times Four to Annualize (Staff Method) | | | | | Times 4 |
| 11 | Staff Proposed Annualized Long Distance Revenues at Present Rates | | | | | [redacted] |
| 12 | Qwest Proposed Test Year Long Distance Revenues (Per UTI 1-1S1, Att. A) | | | | | [redacted] |
| 13 | Staff Adjustment to Annualize Test Year Toll Revenues | | | | | $ 1,076 |

Witness: M. Brosch

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
DIRECTORY ASSISTANCE REVENUE ANNUALIZATION
TEST YEAR ENDING 12/31/2003
(000's)



**CONFIDENTIAL**

| Line No. | Description | Reference | October Amount | November Amount | December Amount | Total Amount |
|---|---|---|---|---|---|---|
| | (A) | (B) | (C) | (D) | (E) | (F) |
| 1 | **Recorded Intrastate Directory Assistance Revenues:** | | | | | |
| 2 | 5060.31 Directory Assistance - Business | UTI 2-06 WPs | [redacted] | | | |
| 3 | 5060.32 Directory Assistance - Residence | " | | | | |
| 4 | 5060.33 Directory Assistance - Public | " | | | | |
| 5 | 5060.34 Directory Assistance - Resale | " | | | | |
| 6 | 5060.39 Directory Assistance - Other | " | | | | |
| 7 | Sum of Analyzed Directory Assistance Revenue Accounts | | | | | |
| 8 | Times Four to Annualize (Staff Method) | | | | | Times 4 |
| 9 | Staff Proposed Annualized Directory Assistance Revenues at Present Rates | | | | | [redacted] |
| 10 | Qwest Proposed Test Year Directory Assistance Revenues | (a) | | | | [redacted] |
| 11 | Staff Adjustment to Annualize Test Year Revenues | | | | | $ 3,705 |

**FOOTNOTES:**

**(a)** 2003 Actual Directory Assistance Revenues per Qwest UTI 2-06 Workpapers

Revised Qwest Adjustment to Annualize DA Revenues (UTI 2-06S2)

Qwest Proposed DA Revenues - TY Annualized

[redacted]

Witness: Carver/Dunkel

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
DSL -- REMOVED FROM INTRASTATE
TEST YEAR ENDING 12/31/2003
(000's)



**CONFIDENTIAL**

| Line No. | Description | Reference | Intrastate As Recorded | ACC Staff DSL Adjustment |
|---|---|---|---|---|
| | (A) | (B) | (C) | (D) |
| [redacted] | | | | |
| | ACC Staff Adjustment to Assign Test Year DSL Expenses to Interstate Operations | | | $ (8,901) |

**FOOTNOTES:**
**(a)** Source: ACC Staff witness Dunkel, Schedule WDA-15 & Workpaper C-6.

Witness: Carver/Dunkel

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
BSI -- CONSTRUCTION RELATED CHARGES
TEST YEAR ENDING 12/31/2003
(000's)



**CONFIDENTIAL**

| Line No. | Description | Reference | Intrastate As Recorded | ACC Staff BSI Adjustment |
|---|---|---|---|---|
| | (A) | (B) | (C) | (D) |
| [redacted] | | | | |
| | ACC Staff Adjustment to Remove Test Year Expenses Related to BSI Construction Charges | | | $ (2,942) |

**FOOTNOTES:**
**(a)** Source: ACC Staff witness Dunkel, Schedule WDA-18 & Workpaper B-4.

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
TELEPHONE PLANT UNDER CONSTRUCTION (TPUC)
TEST YEAR ENDING 12/31/2003
(000'S)



| Line No. | Description | Reference | Intrastate Amount |
|---|---|---|---|
| | (A) | (B) | (C) |
| 1 | Qwest Proposed Inclusion of TPUC in Rate Base | (a) | |
| 2 | Miscellaneous Revenues | (b) | $ (329) |
| 3 | Depreciation Expense | (b) | (71) |
| 4 | Operating Income Before Income Tax | | $ (258) |
| 5 | ACC Staff Adjustment to Remove TPUC Related Revenues/ Expenses and Continue Arizona's Capitalization Method of Accounting | | $ 258 |

**FOOTNOTES:**

**(a)** Qwest proposed to depart from the ACC's capitalization method and adopt the FCC's Revenue Requirement Offset Method.

**(b)** Source: Qwest response to Staff Data Request UTI 1-1S1, Attachment A, Adjustment PFA-04.

| Witness: M. Brosch | QWEST CORPORATION<br>DOCKET NO. T-01051B-03-0454<br>MARKETING & ADVERTISING COSTS<br>TEST YEAR ENDING 12/31/2003 | Schedule C-9<br>Page 1 of 1 |
|---|---|---|

**CONFIDENTIAL**

| Line No. | Description | Reference | Intrastate Amount $000 |
|---|---|---|---|
| | (A) | (B) | (C) |
| [redacted] | | | |
| | Staff Adjustment to Disallow Image/Brand Advertising | | $ (5,507) |

Witness: M. Brosch

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
QWEST WIRELESS EXCESSIVE PRICES
TEST YEAR ENDING 12/31/2003



| Line No. | Description | Reference | Intrastate Amount $000 |
|---|---|---|---|
| | (A) | (B) | (C) |
| 1 | Qwest Corporation Payments to Qwest Wireless at Affiliate Contract Pricing Effective In Test Year | UTI 1-23 A | $ 1,386 |
| 2 | Effective Unit Price per Minute Paid to Qwest Wireless | UTI 7-10 A | $ 0.080 |
| 3 | Best Effective Gold Plan Rate to QW Customers | " | $ 0.050 |
| 4 | Implied Discount to Achieve Best Pricing | 1 - (Line 3 / 2) | 37.5% |
| 5 | Staff Adjustment to Qwest Wireless Billings at Best Price | Line 1 * Line 4 | $ (520) |

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
SOP98-1 (INTERNAL-USE-SOFTWARE)
TEST YEAR ENDING 12/31/2003
(000's)



| Line No. | Description | Reference | Capitalize & Amortize TY Costs | Revised Qwest Adjustment PFA-03 | ACC Staff Adjustment |
|---|---|---|---|---|---|
| | (A) | (B) | (C) | (D) | (E) |
| 1 | Qwest Proposed Inclusion of TPUC in Rate Base | (a) | | | |
| 2 | Corporate Operations -- Test Year Expensed Software | | $ (18,659) | $ (18,659) | $ - |
| 3 | Depreciation Expense -- 5 Year Amortization | | 3,732 | 28,200 | (24,468) |
| 4 | Total Operating Expense | | $ (14,927) | $ 9,541 | $ (24,468) |
| | | | (b) | (c) | |
| 5 | ACC Staff Adjustment to Reverse Qwest's Retroactive Adoption of SOP 98-1 in 1999 and Reflect Prospective Capitalization & Amortization for Arizona Regulatory Purposes | | | | $ (24,468) |

**FOOTNOTES:**

**(a)** In its original filing, Qwest proposed to first recognize the pro forma effect of SOP 98-1 for regulatory purposes in the current rate case. Subsequently in response to Staff Data Request UTI 4-2, Qwest revised its recommendation to retroactively adopt SOP 98-1 for Arizona regulatory purposes effective January 1, 1999.

**(b)** Original Qwest Adjustment PFA-03 did not amortize capitalized test year costs over 5-year period.

**(c)** Source: Qwest response to Staff Data Request UTI 4-1 S1 & revised Adjustment PFA-03.
Also, see the revised response to Staff Data Request UTI 1-1S1.

Witness: M. Brosch

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
RE-AUDIT, D&O INSURANCE & SECURITIES LITIGATION COSTS
TEST YEAR ENDING 12/31/2003



**CONFIDENTIAL**

| Line No. | Description | Reference | Arizona Amount $000 | Intrastate Amount $000 75.48% |
|---|---|---|---|---|
| | (A) | (B) | (C) | (D) |
| 1 | Qwest Recorded Test Year Re-Audit Costs | UTI 1-26A | [redacted] | |
| 2 | Qwest Recorded Test Year Securities Litigation Costs | UTI 1-24S1A | | |
| 3 | Highest AZ Cost for D&O Liability Insurance (last 4 years) | UTI 11-13A | | |
| 4 | Recorded Test Year D&O Insurance to AZ | " | | |
| 5 | Excessive Test Year D&O Insurance Costs | Line 4-3 | | |
| 6 | Total of Test Year Extraordinary Costs | | | |
| 7 | Staff Adjustment to Disallow Qwest Extraordinary Re-audit, D&O and Litigation Costs | | | $ (1,993) |

Witness: M. Brosch

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
ALLOCATION FACTOR UPDATES
TEST YEAR ENDING 12/31/2003
(000's)



**CONFIDENTIAL**

| Line No. | Description | Qwest Service Corp. Charges By Factor UTI 8-44A | Test Year Allocation Factor Booked UTI 8-46A | Annualized 2004 Factor Percentage UTI 8-46A | Factor Difference For Allocation Col D - Col C | Qwest Service Corp. Charges Difference Col E * Col B |
|---|---|---|---|---|---|---|
| | (A) | (B) | (C) | (D) | (E) | (F) |
| 1 | Qwest Services Corporation Allocated Charges: | | | | | |
| 2–34 | [redacted] | | | | | |
| 35 | **Total Adjustment - QSC Charges to QC** | | | | | (7,965) |
| 36 | Approximate Percentage of QC Charges to Arizona (based upon 2004 Weighted Three PFN-06) | | | | | 16.84% |
| 37 | Arizona Portion of QSC Allocation Factor Update | | | | | (1,341) |
| 38 | Intrastate Factor | | | | | 75.48% |
| 39 | Staff Adjustment to Update QSC Allocation Factors | | | | | (1,012) |
| 40 | Add: Update of Centralized Allocations per UTI 2-08, Attachment A | | | | | (286) |
| 41 | Staff Adjustment to Annualize QSC and Centralized Allocation Factors | | | | | $ (1,298) |

Witness: M. Brosch

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
PUBLIC AFFAIRS COSTS
TEST YEAR ENDING 12/31/2003
(000'S)



**CONFIDENTIAL**

| Line No. | Description | Reference | Test Year Arizona Amount $000 | Intrastate Adjustment Amount $000 75.48% |
|---|---|---|---|---|
| | (A) | (B) | (C) | (D) |
| 1 | Total Arizona Public Affairs Public Policy Wages/Benefits | UTI 9-11A | [redacted] | |
| 2 | Less: President, Exec. Assistant and AVP | UTI 9-11A | | |
| 3 | Remaining Director Level Personnel in AZ Public Policy | Lines 1 - 2 | | |
| 4 | Less: Positions Reclassified Below the Line by Staff | | | |
| 5 | Staff Director-External Affairs | UTI 4-09A, 9-11A | [redacted] | [redacted] |
| 6 | Staff Director-Community Affairs | " | | |
| 7 | Staff Disallowed Director/Staff Positions | Lines 3-5-6 | | |
| 8 | Less: Director Legislative Position Already Below the Line | UTI 9-11A | | |
| 9 | Sub-total Regulatory Directors/Staff >>Allowed by Staff | Line 7 - Line 8 | | |
| 10 | Percentage Allowed of Director/Staff | Lines 9 / Line 3 | 51.7% | |
| 11 | Staff Disallowance Percentage | 1 minus Line 10 | **48.3%** | |
| 12 | AZ President, Exec. Assistant and AVP | Line 2 | [redacted] | |
| 13 | Disallowance of AZ President - Supervisory Payroll Method | Line 11 * Line 12 | | |
| 14 | Staff Adjustment to Reclassify Additional Public Policy Costs Below the Line | | | $ (381) |

Witness: M. Brosch

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
QWEST SERVICE CORPORATION COST EXCLUSIONS
TEST YEAR ENDING 12/31/2003
(000's)

Schedule C-15
Page 1 of 1

| Line No. | Description | Reference | Total Amount QSC $000 | Allocated Arizona Amount | Staff Intrastate Adjustment 75.48% |
|---|---|---|---|---|---|
| | (A) | (B) | (C) | (D) | (E) |
| 1 | Nacchio Consulting Payment Disallowance | UTI 15-23B, C | 1,500 | 150 | |
| 2 | Arizona Consulting Payment Disallowance | Line 9, Col D | | (150) | (113) |
| 3 | Intrastate Adjustment to Disallow Certain QSC Expenses | | | | $ (113) |

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
YEAR-END WAGE & SALARY ANNUALIZATION
TEST YEAR ENDING 12/31/2003



**CONFIDENTIAL**

| | | | Management | | | Occupational | | | |
|---|---|---|---|---|---|---|---|---|---|
| Line No. | Description | Reference | Regular Pay (a) | Equivalent Employees (c) | Regular Pay Per Employee | Regular Pay (b) | Equivalent Employees (c) | Regular Pay Per Employee | (000's) Total |
| | (A) | (B) | (C) | (D) | (E) | (F) | (G) | (H) | (I) |
| 1 | **Regular Pay Annualization** | | | | | | | | |
| 2 | Oct-2003 | | [redacted] | | | | | | |
| 3 | Nov-2003 | | | | | | | | |
| 4 | Dec-2003 | | | | | | | | |
| 5 | Average Regular Pay | | | | | | | | |
| 6 | Dec-2003 Employee Equivalent -- regression | | | | | | | | |
| 7 | Times: Annualization Multiplier | | | | | | | | |
| 8 | Annualized Regular Pay | | | | | | | | |
| 9 | Less: Test Year Regular Pay | (a) | | | | | | | |
| 10 | Regular Pay Annualization Adjustment | | | | | | | | |
| 11 | Related Benefits Impact | (d) * line 10 | | | | | | | |
| 12 | Regular Pay & Benefits Annualization Adjustment | | | | | | | | |
| 13 | Operating Expense Allocation Rate | (e) | | | | | | | |
| 14 | Staff Proposed Adjustment to Operating Expense Before Jurisdictional Allocation | | | | | | | | $ (16,575) |

| | Distribution | Total Arizona | %Intrastate (g) | AZ Intrastate |
|---|---|---|---|---|
| Maintenance | 0.35% | $ (57) | 74.4569% | $ (43) |
| Engineering Expense | 7.30% | (1,209) | 72.5289% | (877) |
| Network Operations | 65.54% | (10,864) | 74.0657% | (8,046) |
| Network Administration | 0.13% | (22) | 72.6279% | (16) |
| Customer Operations | 24.84% | (4,118) | 80.3673% | (3,309) |
| Corporate Operations | 1.84% | (305) | 75.4789% | (230) |
| Total | 100.00% | $ (16,575) | | $ (12,522) |

Footnotes on Page 2

**CONFIDENTIAL**

**FOOTNOTES:**

(a) **Management Regular Pay**

| (before clearances) | Basic Wages (EXTC 111) | Paid Absences (EXTC 13x, 149) | Total |
|---|---|---|---|
| Oct-2003 | [redacted] | | |
| Nov-2003 | | | |
| Dec-2003 | | | |
| 12ME Dec-2003 | | | |

Source: Qwest confidential response to Staff Data Request UTI 9-4, Attachment J.

(b) **Occupational Regular Pay**

| (before clearances) | Basic Wages (EXTC 111) | Paid Absences (EXTC 13x, 149) | Total |
|---|---|---|---|
| Oct-2003 | [redacted] | | |
| Nov-2003 | | | |
| Dec-2003 | | | |
| 12ME Dec-2003 | | | |

Source: Qwest confidential response to Staff Data Request UTI 9-4, Attachment K.

(c) Source: Qwest confidential response to Staff Data Request UTI 15-16, Attachment A.

(d) **Related Benefits Impact**

| | Management | Occupational |
|---|---|---|
| FICA | 7.4133% | 7.4133% |
| Savings Plan | 1.9367% | 1.9367% |
| Group Life | 0.2502% | 0.1980% |
| Total | 9.6002% | 9.5480% |

Source: Qwest workpapers supporting Adjustment PFN-05.

(e) **Composite Payroll Allocation Rate** (management & occupational)

| | |
|---|---|
| 2003 Total Payroll Expense | [redacted] |
| 2003 Clearances | |
| Total Payroll (exp & cap) | |

Source: Qwest confidential response to Staff Data Request UTI 9-4, Attachment I.

(f) **Expense Distribution**

| | Basic Wages (EXTC 111) | Paid Absences (EXTC 13x, 149) | Total | Distribution |
|---|---|---|---|---|
| Maintenance | [redacted] | | | 0.35% |
| Engineering Expense | | | | 7.30% |
| Network Operations | | | | 65.54% |
| Network Administration | | | | 0.13% |
| Customer Operations | | | | 24.84% |
| Corporate Operations | | | | 1.84% |
| Total | | | | 100.00% |

(g) Source: Staff Schedule F, Intrastate Separation Factors. Represents corrected Qwest factors. Intrastate separations impact of Staff's treatment of FCC deregulated services is captured in Staff Adjustment B-10 & C-20.

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
INCENTIVE COMPENSATION
TEST YEAR ENDING 12/31/2003



**CONFIDENTIAL**

| Line No. | Description | Category | Total AZ Mgmt & Occup. Bonus (a) | Qwest % Intrastate | As Recorded Arizona Intrastate | Less: Qwest ADJ PFN-08 (b) | Adjusted Arizona Intrastate |
|---|---|---|---|---|---|---|---|
| | (A) | (B) | (C) | (D) | (E) | (F) | (G) |
| 1 | 6124, General Purpose Computers | Maint. Exp. | [redacted] | 74.46% | [redacted] | [redacted] | [redacted] |
| 2 | 6532, Network Administration | Maint. Exp. | [redacted] | 72.63% | [redacted] | [redacted] | [redacted] |
| 3 | 6534, Plant Operations Administration | Maint. Exp. | [redacted] | 74.07% | [redacted] | [redacted] | [redacted] |
| 4 | 6535, Engineering | Engin. Exp. | [redacted] | 72.53% | [redacted] | [redacted] | [redacted] |
| 5 | 6611, Product Management | Cust. Ops. Exp. | [redacted] | 80.37% | [redacted] | [redacted] | [redacted] |
| 6 | 6612, Sales | Cust. Ops. Exp. | [redacted] | 80.37% | [redacted] | [redacted] | [redacted] |
| 7 | 6621, Call Completion Services | Cust. Ops. Exp. | [redacted] | 80.37% | [redacted] | [redacted] | [redacted] |
| 8 | 6622, Number Services | Cust. Ops. Exp. | [redacted] | 80.37% | [redacted] | [redacted] | [redacted] |
| 9 | 6623, Customer Services | Cust. Ops. Exp. | [redacted] | 80.37% | [redacted] | [redacted] | [redacted] |
| 10 | 6711, Executive | Corp. Ops. Exp. | [redacted] | 75.48% | [redacted] | [redacted] | [redacted] |
| 11 | 6721, Accounting and Finance | Corp. Ops. Exp. | [redacted] | 75.48% | [redacted] | [redacted] | [redacted] |
| 12 | 6722, External Relations | Corp. Ops. Exp. | [redacted] | 75.48% | [redacted] | [redacted] | [redacted] |
| 13 | 6723, Human Resources | Corp. Ops. Exp. | [redacted] | 75.48% | [redacted] | [redacted] | [redacted] |
| 14 | 6724, Information Management | Corp. Ops. Exp. | [redacted] | 75.48% | [redacted] | [redacted] | [redacted] |
| 15 | 6728, Other General and Administrative | Corp. Ops. Exp. | [redacted] | 75.48% | [redacted] | [redacted] | [redacted] |
| 16 | Total | | [redacted] | | [redacted] | [redacted] | [redacted] |
| 17 | Less: Allocation to Capital Accounts (b) | 16.05% | | | [redacted] | [redacted] | [redacted] |
| 18 | Incentive Pay Charged to Operating Expense | | | | [redacted] | [redacted] | [redacted] |
| 19 | Staff Allowance Percentage (c) | | | | [redacted] | [redacted] | [redacted] |
| 20 | Allowed Incentive Compensation | | | | [redacted] | [redacted] | [redacted] |

| | | | |
|---|---|---|---|
| 21 | ACC Staff Adjustment to Disallow Incentive Compensation Expense Associated with Corporate Financial Indicators | Line 20 - Line 18 | $ (5,721,503) |
| | | (000's) | $ (5,722) |

**FOOTNOTES:**

(a) Source: Qwest response to UTI 9-3, Confidential Attachment A.
(b) Source: Qwest workpapers supporting Adjustment PFN-08.
(c) Source: Staff Workpaper C-17.
(d) Staff Adjustment Distibution

| | | |
|---|---|---|
| Maint. Exp. | 56.69% | $ (3,244) |
| Engin. Exp. | 19.30% | (1,104) |
| Cust. Ops. Exp. | 21.45% | (1,227) |
| Corp. Ops. Exp. | 2.55% | (146) |
| Total | 100.00% | $ (5,722) |

(e) Source: Staff Schedule F, Intrastate Separation Factors. Represents corrected Qwest factors. Intrastate separations impact of Staff's treatment of FCC deregulated services is captured in Staff Adjustment B-10 & C-20.

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
FAS106 OPEB COSTS
TEST YEAR ENDING 12/31/2003
(000's)

Schedule C-18
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**CONFIDENTIAL**

| Line No. | Description | Reference | Qwest Proposed Amortization | Staff Proposed Amortization | ACC Staff Adjustment |
|---|---|---|---|---|---|
| | (A) | (B) | (C) | (D) | (E) |
| | OPEB -- APBO Amortization | | | | |
| 1 | Qwest estimated Medical APBO | | [redacted] | | |
| 2 | % Allocation to Arizona | | | | |
| 3 | Arizona APBO -- Total State | Line 1 * 2 | | | |
| 4 | Arizona reg. intrastate % | (c) | | | |
| 5 | Arizona Intrastate APBO | Line 3 * 4 | | | |
| 6 | TBO Amortization Period | (d) (e) | | | |
| 7 | Annual APBO Amortization | Line 5 * 6 | | | |
| 8 | % Allocation to Operating Expense | | | | |
| 9 | APBO Amortization -- Expense Allocation | | | | |
| | | | (a) | (b) | |
| 10 | ACC Staff Adjustment to Recognize OPEB APBO Amortization Based on Qwest Proposal in the 1999 Rate Case (Docket T-1051B-99-105) | Col D - Col C | | | $ (35,843) |

| Adjustment Distribution | OPEB Per Book | %Intrastate (c) | Intrastate $ | % Distribution | Adjustment |
|---|---|---|---|---|---|
| Maintenance | [redacted] | 74.4569% | [redacted] | 35.53% | $ (12,736) |
| Engineering Expense | | 72.5289% | | 2.66% | (953) |
| Network Operations | | 74.0657% | | 23.25% | (8,332) |
| Network Administration | | 72.6279% | | 0.37% | (133) |
| Access Expense | | 24.7584% | | 0.00% | - |
| Other | | 73.0672% | | 0.23% | (83) |
| Total Cost of Services & Products | | | | 62.04% | (22,238) |
| Customer Operations | | 80.3673% | | 36.12% | (12,948) |
| Corporate Operations | | 75.4789% | | 1.83% | (657) |
| Property & Other Taxes | | 73.4666% | | 0.00% | - |
| Uncollectibles | | 78.6675% | | 0.00% | - |
| Total Selling, General and Administrative | | | | 37.96% | (13,606) |
| Total | | 76.4585% | | 100.00% | $ (35,843) |
| | (a) | | | (a) | |

**FOOTNOTES:**

**(a)** Source: Qwest Adjustment PFA-02, revised Staff Data Request UTI 1-1S1.
**(b)** Source: Qwest confidential response to Staff Data Request UTI 47-11, Docket T-1051B-99-105.
**(c)** Source: Staff Schedule F, Intrastate Separation Factors. Represents corrected Qwest factors. Intrastate separations impact of Staff's treatment of FCC deregulated services is captured in Staff Adjustment B-10 & C-20.

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
FCC DEREGULATED SERVICES -- REVENUE IMPUTATION
TEST YEAR ENDING 12/31/2003
(000's)

Schedule C-19
Page 1 of 1

**CONFIDENTIAL**

| Line No. | Description (A) | | Qwest ATL FCC Dereg (excl. B&C) (B) | Qwest ATL Remove Payphone (C) | Remove Planning/ Payphone "Correction" (D) | Remove FCC Dereg In AZ Price Cap Baskets (E) | Remove "Corrected" Voice Messaging (State Dereg Rec.) (F) | Qwest Pro Forma Adjustments (G) | Total "Corrected" FCC Dereg Remaining ATL (H) | FCC Dereg Staff Revenue 50% Imputation (I) | Adjusted FCC Dereg Remaining ATL (J) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Revenues** | | | | | | | | | | |
| 1 | Miscellaneous | | [redacted] | | | | | | | | |
| 2 | Total Operating Revenues | | | | | | | | | | |
| | **Expenses** | | | | | | | | | | |
| 3 | Maintenance | | | | | | | | | | |
| 4 | Engineering Expense | | | | | | | | | | |
| 5 | Network Operations | | | | | | | | | | |
| 6 | Network Administration | | | | | | | | | | |
| 7 | Other | | | | | | | | | | |
| 8 | Total Cost of Services & Products | | | | | | | | | | |
| 9 | Customer Operations | | | | | | | | | | |
| 10 | Corporate Operations | | | | | | | | | | |
| 11 | Property & Other Taxes | | | | | | | | | | |
| 12 | Uncollectibles | | | | | | | | | | |
| 13 | Total Selling, General and Administrative | | | | | | | | | | |
| 14 | Other Operating Income & Expense | | | | | | | | | | |
| 15 | Depreciation Expense | | | | | | | | | | |
| 16 | Total Operating Expense | | | | | | | | | | |
| 17 | **Income From Operations** | | | | | | | | | | |
| 18 | Federal Income Tax | 32.561% | | | | | | | | | |
| 19 | State & Local Income Tax | 6.968% | | | | | | | | | |
| 20 | **Net Operating Income** | | | | | | | | | | |
| 21 | **Rate Base** | | | | | | | | | | |
| 22 | Telephone Plant In Service | | | | | | | | | | |
| 23 | Materials and Supplies | | | | | | | | | | |
| 24 | Accumulated Depr & Amort Reserve | | | | | | | | | | |
| 25 | Accumulated Deferred Income Tax | | | | | | | | | | |
| 26 | Customer Deposits | | | | | | | | | | |
| 27 | **End-Of-Period Rate Base** | | | | | | | | | | |
| 28 | **Return On Investment** | | | | | | | | | | |

**FOOTNOTES:**

**(a)** *Source:* Qwest spreadsheet "az1203_Revised 10-27-04.xls" & sheet "Interface-1990Financials".
**(b)** Source: Qwest spreadsheet "az1203_Revised 10-27-04.xls" & *Adjustment* PFN-12, Planning for Enhanced Services.
**(c)** Source: Staff Adjustment C-1 & Qwest Adjustments PFN-03, Revised Operating Income Annualization (trending), & PFN-01, Revised *Out of Period* Revenues.
**(d)** **Revenue Imputation Adjustment**

End-Of-Period Rate Base
Staff Proposed Rate of Return
Operating Income Required
Net Operating Income Available
Operating Income Deficiency
Revenue Conversion Factor
Revenue Deficiency (Excess)
ACC Allowance D. 58927
Staff Proposed Imputation

[redacted]

**(e)** Source: Staff Workpaper C-19 & Qwest confidential response to Staff Data Request UTI 9-9, Attachment B -- corrected for Planning for Enhanced Services.

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
FCC DEREGULATED SERVICES -- SEPARATIONS ADJUSTMENT
TEST YEAR ENDING 12/31/2003
(000's)



| Line No. | Description (A) | Qwest PFA (B) | Qwest PFN (excl. sep. adj.) (C) | Qwest PFR (D) | Total Qwest Adjustments (excl. sep. adj.) (E) | Staff Adjustments (excl. sep. adj.) (F) | Total Qwest & Staff Adjustments (G) | %Intrastate Net Change Ratio (c) (H) | Effect of Separations Factor Changes (I) | FCC Dereg 50% Imputation (J) |
|---|---|---|---|---|---|---|---|---|---|---|
| | | Intrastate Adjustments | | | | | | | | |
| | **Revenues** | | | | | | | | | |
| 1 | Local Service Revenues | | $ (59,142) | | $ (59,142) | $ 5,863 | $ (53,279) | n/a | n/a | n/a |
| 2 | Network Access | | (3,886) | | (3,886) | 3,221 | (665) | n/a | n/a | n/a |
| 3 | Long Distance | | (2,343) | | (2,343) | 1,309 | (1,034) | n/a | n/a | n/a |
| 4 | Miscellaneous | $ (329) | 6,842 | $ 73,363 | 79,876 | (8,568) | 71,308 | n/a | n/a | n/a |
| 5 | Total Operating Revenues | (329) | (58,529) | 73,363 | 14,505 | 1,826 | 16,330 | | | |
| | **Expenses** | | | | | | | | | |
| 6 | Maintenance | 21,871 | (12,670) | | 9,201 | (24,263) | (15,062) | -13.7394% | $ 2,069 | $ 1,035 |
| 7 | Engineering Expense | 1,636 | (142) | | 1,494 | (3,142) | (1,647) | -0.0907% | 1 | 1 |
| 8 | Network Operations | 14,308 | 221 | | 14,529 | (19,039) | (4,510) | -13.7230% | 619 | 309 |
| 9 | Network Administration | 229 | 1 | | 230 | (185) | 45 | -0.5514% | (0) | (0) |
| 10 | Access Expense | | | | - | - | - | 0.0000% | - | - |
| 11 | Other | 142 | - | | 142 | (103) | 39 | -1.7507% | (1) | (0) |
| 12 | Total Cost of Services & Products | 38,187 | (12,590) | - | 25,597 | (46,732) | (21,135) | | 2,689 | 1,344 |
| 13 | Customer Operations | - | (290) | | (290) | (21,760) | (22,050) | 0.0000% | - | - |
| 14 | Corporate Operations | 3,576 | (20,515) | (1,125) | (18,064) | (34,153) | (52,216) | -7.2374% | 3,779 | 1,890 |
| 15 | Property & Other Taxes | 52 | (823) | | (771) | (1,335) | (2,107) | -4.9151% | 104 | 52 |
| 16 | Uncollectibles | - | (2,209) | | (2,209) | (65) | (2,274) | -1.1692% | 27 | 13 |
| 17 | Total Selling, General and Administrative | 3,628 | (23,837) | (1,125) | (21,334) | (57,313) | (78,647) | | 3,909 | 1,955 |
| 18 | Other Operating Income & Expense | | (208) | 198 | (10) | 0 | (10) | -5.3458% | 1 | 0 |
| 19 | Depreciation Expense | (81,572) | 5,823 | (14) | (75,763) | (152,897) | (228,660) | 0.0000% | - | - |
| 20 | Universal Service Fund | | | | - | - | - | -1.8480% | - | - |
| 21 | Link Up America | | | | - | - | - | -1.4535% | - | - |
| 22 | Total Operating Expense | (39,757) | (30,812) | (941) | (71,510) | (256,942) | (328,451) | | $ 6,599 | |
| | | (a) | (a) | (a) | | (b) | | | | |
| 23 | ACC Staff Adjustment to Reflect 50% of Separations Correction Associated with FCC Deregulated Services | | | | | | | | | $ 3,299 |

**FOOTNOTES:**

(a) Source: Qwest response to Staff Data Request UTI 1-1S1, Attachment A, excluding PFN-14 & PFN-17.
(b) Source: Staff Schedule C, p. 1, excluding Adjustment C-20.
(c) Source: Staff Schedule F, Intrastate Separations Factors.

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
INTEREST SYNCHRONIZATION
TEST YEAR ENDING 12/31/2003
(000's)

Witness: S. Carver

Schedule C-21
Page 1 of 1

| Line No. | Description | Reference | Amount |
|---|---|---|---|
| | (A) | (B) | (C) |
| 1 | Staff Proposed Rate Base | Staff Sch. B | $ 1,559,949 |
| 2 | Staff Proposed Weighted Debt Cost | Staff Sch. D | 5.87% |
| 3 | Staff Proposed Interest Expense | Line 1 * Line 2 | $ 91,581 |
| 4 | Less: Qwest Pro Forma Interest Expense | (a) | 99,063 |
| 5 | Staff Interest Expense Adjustment | Line 3 + Line 4 | $ (7,481) |
| 6 | **ACC STAFF ADJUSTMENT TO SYNCHRONIZE INTEREST** | | |
| 7 | State Income Tax Effect on Staff Synchronized Interest | 6.9680% | $ 521 |
| 8 | Federal Income Tax Effect on Staff Synchronized Interest | 32.5612% | 2,436 |
| 9 | Total Staff Income Tax on Synchonized Interest | | $ 2,957 |

**FOOTNOTES:**

**(a)** Source: Qwest Adjustment PFR-03, workpapers supporting Qwest response to Staff Data Request UTI 1-1S1.

Witness: Carver/Dunkel

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
DEPRECIATION ANNUALIZATION - 12/31/03 RESERVE UPDATE
TEST YEAR ENDING 12/31/2003

Schedule C-22
Page 1 of 1

**CONFIDENTIAL**

| Line No. | Description | Account | Depreciable Plant In Service at 12/31/03 [excl. FCC Dereg] | Staff Proposed Adjustments to Depreciable Plant | Staff Proposed Depreciable Plant In Service at 12/31/03 | Staff Proposed Depr. Rates 12/31/03 Update [Note (d)] | Pro Forma Depreciation | Staff Adjustment (000's) |
|---|---|---|---|---|---|---|---|---|
| | (A) | (B) | (C) | (D) | (E) | (F) | (G) | (H) |
| 1 | Motor Vehicles | 2112 | [redacted] | [redacted] | $ 50,002,464 | 6.9% | $ 3,450,170 | |
| 2 | Special Pupose Vehicles | 2114 | [redacted] | [redacted] | 18,258 | 12.8% | 2,337 | |
| 3 | Garage Work Equipment | 2115 | [redacted] | [redacted] | 1,074,994 | 13.3% | 142,974 | |
| 4 | Other Work Equipment | 2116 | [redacted] | [redacted] | 26,803,631 | 7.2% | 1,929,861 | |
| 5 | Buildings | 2121 | [redacted] | [redacted] | 168,555,110 | 3.3% | 5,562,319 | |
| 6 | Furniture | 2122 | [redacted] | [redacted] | 1,253,232 | 4.0% | 50,129 | |
| 7 | Office Equipment | 2123.1 | [redacted] | [redacted] | 4,185,608 | 0.0% | - | |
| 8 | Company Communications Equipment | 2123.2 | [redacted] | [redacted] | 1,719,023 | 1.7% | 29,223 | |
| 9 | General Purpose Computer | 2124 | [redacted] | [redacted] | 68,106,771 | 0.0% | - | |
| 10 | Digital Switching Equipment | 2212 | [redacted] | [redacted] | 895,201,225 | 8.1% | 72,511,299 | |
| 11 | Operator Systems | 2220 | [redacted] | [redacted] | 1,962,173 | 25.8% | 506,241 | |
| 12 | Radio Systems | 2231 | [redacted] | [redacted] | 20,997,530 | 0.7% | 146,983 | |
| 13 | Circuit DDS | 2232 | [redacted] | [redacted] | 3,516,888 | 2.0% | 70,338 | |
| 14 | Circuit Digital | 2232 | [redacted] | [redacted] | 1,005,772,853 | 7.1% | 71,409,873 | |
| 15 | Circuit Analog | 2232 | [redacted] | [redacted] | 25,337,555 | 0.0% | - | |
| 16 | Other Terminal Equipment | 2362 | [redacted] | [redacted] | 51,022,353 | 6.4% | 3,265,431 | |
| 17 | Pole Lines | 2411 | [redacted] | [redacted] | 38,664,356 | 5.9% | 2,281,197 | |
| 18 | Aerial Cable - Metallic | 2421 | [redacted] | [redacted] | 145,481,495 | 4.4% | 6,401,186 | |
| 19 | Aerial Cable - Non Metallic | 2421 | [redacted] | [redacted] | 6,839,595 | 9.5% | 649,762 | |
| 20 | Underground Cable - Metallic | 2422 | [redacted] | [redacted] | 283,502,726 | 4.2% | 11,907,114 | |
| 21 | Underground Cable - Non Metallic | 2422 | [redacted] | [redacted] | 131,535,797 | 8.3% | 10,917,471 | |
| 22 | Buried Cable - Metallic | 2423 | [redacted] | [redacted] | 1,193,055,976 | 6.5% | 77,548,638 | |
| 23 | Buried Cable - Non Metallic | 2423 | [redacted] | [redacted] | 16,071,258 | 6.6% | 1,060,703 | |
| 24 | Submarine Cable - Metallic | 2424 | [redacted] | [redacted] | 1,887 | 0.0% | - | |
| 25 | Submarine Cable - Non Metallic | 2424 | [redacted] | [redacted] | - | 0.0% | - | |
| 26 | Intrabuilding Cable - Metallic | 2426 | [redacted] | [redacted] | 31,755,876 | 3.0% | 952,676 | |
| 27 | Intrabuilding Cable - Non Metallic | 2426 | [redacted] | [redacted] | 773,315 | 6.3% | 48,719 | |
| 28 | Aerial Wire | 2431 | [redacted] | [redacted] | 8,068,659 | 7.5% | 605,149 | |
| 29 | Conduit Systems | 2441 | [redacted] | [redacted] | 329,531,777 | 2.2% | 7,249,699 | |
| 30 | Total Intrastate Depreciable Plant | | $ 4,600,342,426 | $ (89,530,040) | $ 4,510,812,386 | | 278,699,493 | |
| | | | (a) (b) | (e) | (a) (b) | | | |
| 31 | Less: Per Book Depreciation Expense (c) | | | | | | (445,280,010) | |
| 32 | Add: Qwest Pro Forma Depreciation Adjustment PFA-01 | | | | | | 109,701,000 | |
| 33 | Less: Qwest Pro Forma Depreciation Adjustment PFN-11 | | | | | | (6,001,000) | |
| 34 | Add: Staff Adjustments C-6 & C-7, DSL & BSI Depreciation (e) | | | | | | 8,362,037 | |
| 35 | ACC Staff Adjustment to Annualize Book Depreciation Expense Based on Updated Book Depreciation Reserve at 12/31/03 | | | | | | $ (54,518,480) | $ (54,518) |

**FOOTNOTES:**

**(a)** Source: Depreciable plant at 12/31/03 per workpapers supporting Qwest Adjustments PFA-01 & PFN-11.

**(b)** Plant Reconciliation: (000's)

| | |
|---|---|
| Intrastate Depreciable Plant | $ 4,510,812 |
| Land | 12,813 |
| Capital Leases | 5,132 |
| Leasehold Improvements | 32,889 |
| Intangibles | 106,910 |
| FCC Dereg | 105,400 |
| Rounding | (18) |
| Qwest Intrastate Plant In Service | $ 4,773,938 |

Source: Qwest response to Staff Data Request UTI 2-27.

**(c)** Source: Staff Workpaper C-22.

**(d)** Direct Testimony of Staff Witness Dunkel, Schedule WDA-8, p. 1 of 5.

**(e)** Source: Confidential Staff Adjustments B-3 (DSL plant), B-4 (BSI plant), C-6 (DSL depreciation) & C-7 (BSI depreciation).

Witness: Carver/Dunkel

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
DEPRECIATION ANNUALIZATION - STAFF PROPOSED RATES
TEST YEAR ENDING 12/31/2003



| Line No. | Description | Account | Staff Proposed Depreciable Plant In Service at 12/31/03 | Staff Proposed Depr. Rates Parameter Update [Note (b)] | Pro Forma Depreciation | Staff Adjustment (000's) |
|---|---|---|---|---|---|---|
| | (A) | (B) | (C) | (D) | (E) | (F) |
| 1 | Motor Vehicles | 2112 | $ 50,002,464 | 6.9% | $ 3,450,170 | |
| 2 | Special Pupose Vehicles | 2114 | 18,258 | 12.8% | 2,337 | |
| 3 | Garage Work Equipment | 2115 | 1,074,994 | 13.3% | 142,974 | |
| 4 | Other Work Equipment | 2116 | 26,803,631 | 7.2% | 1,929,861 | |
| 5 | Buildings | 2121 | 168,555,110 | 3.3% | 5,562,319 | |
| 6 | Furniture | 2122 | 1,253,232 | 4.0% | 50,129 | |
| 7 | Office Equipment | 2123.1 | 4,185,608 | 0.0% | - | |
| 8 | Company Communications Equipment | 2123.2 | 1,719,023 | 1.7% | 29,223 | |
| 9 | General Purpose Computer | 2124 | 68,106,771 | 0.0% | - | |
| 10 | Digital Switching Equipment | 2212 | 895,201,225 | 5.4% | 48,340,866 | |
| 11 | Operator Systems | 2220 | 1,962,173 | 25.8% | 506,241 | |
| 12 | Radio Systems | 2231 | 20,997,530 | 0.7% | 146,983 | |
| 13 | Circuit DDS | 2232 | 3,516,888 | 2.5% | 87,922 | |
| 14 | Circuit Digital | 2232 | 1,005,772,853 | 6.3% | 63,363,690 | |
| 15 | Circuit Analog | 2232 | 25,337,555 | 0.0% | - | |
| 16 | Other Terminal Equipment | 2362 | 51,022,353 | 6.4% | 3,265,431 | |
| 17 | Pole Lines | 2411 | 38,664,356 | 3.4% | 1,314,588 | |
| 18 | Aerial Cable - Metallic | 2421 | 145,481,495 | 2.6% | 3,782,519 | |
| 19 | Aerial Cable - Non Metallic | 2421 | 6,839,595 | 3.4% | 232,546 | |
| 20 | Underground Cable - Metallic | 2422 | 283,502,726 | 3.5% | 9,922,595 | |
| 21 | Underground Cable - Non Metallic | 2422 | 131,535,797 | 2.7% | 3,551,467 | |
| 22 | Buried Cable - Metallic | 2423 | 1,193,055,976 | 3.2% | 38,177,791 | |
| 23 | Buried Cable - Non Metallic | 2423 | 16,071,258 | 3.0% | 482,138 | |
| 24 | Submarine Cable - Metallic | 2424 | 1,887 | 0.0% | - | |
| 25 | Submarine Cable - Non Metallic | 2424 | - | 0.0% | - | |
| 26 | Intrabuilding Cable - Metallic | 2426 | 31,755,876 | 2.4% | 762,141 | |
| 27 | Intrabuilding Cable - Non Metallic | 2426 | 773,315 | 2.7% | 20,880 | |
| 28 | Aerial Wire | 2431 | 8,068,659 | 4.9% | 395,364 | |
| 29 | Conduit Systems | 2441 | 329,531,777 | 2.2% | 7,249,699 | |
| 30 | Total Intrastate Depreciable Plant | | $ 4,510,812,386 (a) | | 192,769,874 | |
| 31 | Less: Staff Proposed Technical Update (a) | | | | (278,699,493) | |
| 32 | ACC Staff Adjustment to Annualize Book Depreciation Expense Based on Staff's Updated Service Lives & Net Salvage | | | | $ (85,929,619) | $ (85,930) |

**FOOTNOTES:**

**(a)** Source: Staff Adjustment C-22.

**(b)** Direct Testimony of Staff Witness Dunkel, Schedule WDA-8, p. 1 of 5.

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
VOICE MESSAGING -- STATE DEREGULATED SERVICE
TEST YEAR ENDING 12/31/2003
(000's)



**CONFIDENTIAL**

| Line No. | Description | "Corrected" Voice Messaging (State Dereg) | Staff Adjustment Removing Voice Messaging |
|---|---|---|---|
| | (A) | (B) | (C) |
| | **Revenues** | | |
| 1 | Miscellaneous | [redacted] | |
| 2 | Total Operating Revenues | | |
| | **Expenses** | | |
| 3 | Maintenance | | |
| 4 | Engineering Expense | | |
| 5 | Network Operations | | |
| 6 | Network Administration | | |
| 7 | Other | | |
| 8 | Total Cost of Services & Products | | |
| 9 | Customer Operations | | |
| 10 | Corporate Operations | | |
| 11 | Property & Other Taxes | | |
| 12 | Uncollectibles | | |
| 13 | Total Selling, General and Administrative | | |
| 14 | Other Operating Income & Expense | | |
| 15 | Depreciation Expense | | |
| 16 | Total Operating Expense | | |
| 17 | **Income From Operations** | | |
| 18 | Federal Income Tax | | |
| 19 | State & Local Income Tax | | |
| 20 | **Net Operating Income** | | |
| | | (a) | |
| 21 | ACC Staff Adjustment to Remove Test Year Revenues and Expenses Consistent with Staff Recommendation to Deregulated Voice Messaging Services | | $ (2,184) |

**FOOTNOTES:**

**(a)** Source: Staff Workpaper C-19 & Qwest confidential response to Staff Data Request UTI 9-9, Attachment B -- corrected for Planning for Enhanced Services.

Witnesses: Reiker/Ramirez

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
CAPITAL STRUCTURE & COSTS
TEST YEAR ENDING 12/31/2003
(000's)



| Line No. | Description | Capital Amount | Capital Ratio | Cost Rates | Composite Cost |
|---|---|---|---|---|---|
| | (A) | (B) | (C) | (D) | (E) |
| | **Qwest Proposed** | | | | |
| 1 | Long Term Debt | $ 1,098,801 | 66.50% | 7.89% | 5.248% |
| 2 | Short Term Debt | 144,202 | 8.70% | 7.24% | 0.630% |
| 3 | Total Debt | 1,243,002 | 75.20% | 7.82% | 5.877% |
| 4 | Common Equity | 410,503 | 24.80% | 21.40% | 5.307% |
| 5 | Total Capital | $ 1,653,505.0 | 100.00% | | **11.180%** |
| | **ACC Proposed** | | | | |
| 6 | Debt | | 75.17% | 7.81% | 5.87% |
| 7 | Common Equity | | 24.83% | 14.60% | 3.63% |
| 8 | Total Capital | | 100.00% | | 9.50% |

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
RECONCILIATION OF POSITIONS
TEST YEAR ENDING 12/31/2003
(000's)



| Line No. | Sch/ Adj. Ref. | Description | Amount | Difference In Pretax Return | Revenue Requirement Value |
|---|---|---|---|---|---|
| | | (A) | (B) | (C) | (D) |
| 1 | SCH. A | **Qwest Revenue Requirement** | | | $ 318,529 |
| 2 | SCH. B | **Return Difference At Qwest Rate Base** | $ 1,643,001 | -2.85% | (46,823) |
| 3 | | Subtotal Revenue Requirement | | | $ 271,705 |
| | | | | **PRE-TAX RETURN** | |
| 4 | | **STAFF RATE BASE ADJUSTMENTS** | | | |
| 5 | B-1 | QWEST UPDATE - CORRECTIONS & REVISIONS | 43,087 | 12.13% | $5,228 |
| 6 | B-2 | CASH WORKING CAPITAL | (10,717) | 12.13% | (1,300) |
| 7 | B-3 | DSL -- REMOVED FROM INTRASTATE | (33,031) | 12.13% | (4,008) |
| 8 | B-4 | BSI -- CONSTRUCTION RELATED CHARGES | (26,622) | 12.13% | (3,230) |
| 9 | B-5 | TELEPHONE PLANT UNDER CONSTRUCTION (TPUC) | (20,066) | 12.13% | (2,435) |
| 10 | B-6 | SOP 98-1 (INTERNAL-USE-SOFTWARE) | (47,135) | 12.13% | (5,719) |
| 11 | B-7 | DEPRECIATION RESERVE CORRECTION | (63,014) | 12.13% | (7,646) |
| 12 | B-8 | FAS106 OPEB COSTS | 78,732 | 12.13% | 9,553 |
| 13 | B-9 | VOICE MESSAGING -- STATE DEREGULATED SERVICE | (4,622) | 12.13% | (561) |
| 14 | B-10 | FCC DEREGULATED SERVICES -- SEPARATIONS ADJUSTMENT | 335 | 12.13% | 41 |
| 15 | | Total Value of Staff Rate Base Adustments | (83,052) | | $ (10,077) |
| 16 | | Staff Rate Base Recommendation | $ 1,559,949 | | |
| 17 | SCH. A | **Qwest Proposed Net Operating Income** | $ (5,056) | **REVENUE CONVERSION MULTIPLIER** | |
| | | **STAFF NET OPERATING INCOME ADJUSTMENTS** | | | |
| 18 | C-1 | QWEST UPDATE - CORRECTIONS & REVISIONS | 5,366 | 1.6876 | ($9,056) |
| 19 | C-2 | LOCAL SERVICE REVENUE CORRECTION | 479 | 1.6876 | (808) |
| 20 | C-3 | ACCESS REVENUE ANNUALIZATION | (80) | 1.6876 | 135 |
| 21 | C-4 | TOLL REVENUE ANNUALIZATION | 651 | 1.6876 | (1,098) |
| 22 | C-5 | DIRECTORY ASSISTANCE REVENUE ANNUALIZATION | 2,240 | 1.6876 | (3,781) |
| 23 | C-6 | DSL -- REMOVED FROM INTRASTATE | 5,382 | 1.6876 | (9,084) |
| 24 | C-7 | BSI -- CONSTRUCTION RELATED CHARGES | 1,779 | 1.6876 | (3,002) |
| 25 | C-8 | TELEPHONE PLANT UNDER CONSTRUCTION (TPUC) | 156 | 1.6876 | (263) |
| 26 | C-9 | MARKETING & ADVERTISING COSTS | 3,330 | 1.6876 | (5,620) |
| 27 | C-10 | QWEST WIRELESS EXCESSIVE PRICES | 314 | 1.6876 | (530) |
| 28 | C-11 | SOP98-1 (INTERNAL-USE-SOFTWARE) | 14,796 | 1.6876 | (24,970) |
| 29 | C-12 | RE-AUDIT, D&O INSURANCE & SECURITIES LITIGATION COSTS | 1,205 | 1.6876 | (2,034) |
| 30 | C-13 | ALLOCATION FACTOR UPDATES | 785 | 1.6876 | (1,325) |
| 31 | C-14 | PUBLIC AFFAIRS COSTS | 230 | 1.6876 | (389) |
| 32 | C-15 | QWEST SERVICE CORPORATION COST EXCLUSIONS | 69 | 1.6876 | (116) |
| 33 | C-16 | YEAR-END WAGE & SALARY ANNUALIZATION | 7,572 | 1.6876 | (12,779) |
| 34 | C-17 | INCENTIVE COMPENSATION | 3,460 | 1.6876 | (5,839) |
| 35 | C-18 | FAS106 OPEB COSTS | 21,675 | 1.6876 | (36,579) |
| 36 | C-19 | FCC DEREGULATED SERVICES -- REVENUE IMPUTATION | 3,897 | 1.6876 | (6,576) |
| 37 | C-20 | FCC DEREGULATED SERVICES -- SEPARATIONS ADJUSTMENT | (1,995) | 1.6876 | 3,367 |
| 38 | C-21 | INTEREST SYNCHRONIZATION | (2,957) | | 0 |
| 39 | C-22 | DEPRECIATION ANNUALIZATION - 12/31/03 RESERVE UPDATE | 32,968 | 1.6876 | (55,637) |
| 40 | C-23 | DEPRECIATION ANNUALIZATION - STAFF PROPOSED RATES | 51,962 | 1.6876 | (87,693) |
| 41 | C-24 | VOICE MESSAGING -- STATE DEREGULATED SERVICE | (2,184) | 1.6876 | 3,685 |
| 42 | C-25 | **reserved** | 0 | 1.6876 | 0 |
| 43 | | Total Value of Staff Net Operating Income Adj. | 151,100 | | $ (259,992) |
| 44 | SCH. A | Staff Net Operating Income Recommendation | $ 146,044 | | |
| | | **OTHER RECONCILING ITEMS** | | | |
| 45 | SCH. A | Error in Qwest Revenue Conversion Factor | | | $ 1,554 |
| 46 | | RECONCILED REVENUE REQUIREMENT | | | $ 3,190 |
| 47 | | UNRECONCILED DIFFERENCE | | | **340** |
| 48 | SCH. A | **STAFF REVENUE REQUIREMENT RECOMMENDATION** | | | $ 3,530 |

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
CALCULATION OF PRE-TAX RETURN
TEST YEAR ENDING 12/31/2003



| Line No. | Description | Weighted Cost (Sch. D) | Revenue Conversion Multiplier (a) (b) | Pretax Return |
|---|---|---|---|---|
| | (A) | (B) | (C) | (D) |
| | **Qwest Proposed** | | | |
| 1 | Long Term Debt | 5.248% | | |
| 2 | Short Term Debt | 0.630% | | |
| 3 | Total Debt | 5.877% | 1.0255 | 6.027% |
| 4 | Common Equity | 5.307% | 1.6876 | 8.956% |
| 5 | Total Capital | **11.180%** | | 14.983% |
| | **ACC Proposed** | | | |
| 6 | Debt | 5.871% | 1.0225 | 6.003% |
| 7 | Common Equity | 3.63% | 1.6910 | 6.130% |
| 8 | Total Capital | **9.50%** | | 12.133% |
| 9 | DIFFERENCE IN PRE-TAX RETURNS | | | -2.850% |

Witness: S. Carver

QWEST CORPORATION
DOCKET NO. T-01051B-03-0454
INTRASTATE SEPARATION FACTORS
TEST YEAR ENDING 12/31/2003
(000's)

Schedule F
Page 1 of 1

| | | | | | | | | Qwest Revised (includes FCC Dereg) | | Staff Proposed (excludes Adj. C-19 FCC Dereg) | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Line No. | Description | Total State MR | Total State JD | Total State JR (d=b+c) | Intrastate JR | FCC Dereg Excl. Billing & Collection | Payphone (incl. Enhanced Svc Reclass) | Regulated Intrastate (h=e+f-g) | Intrastate Factor (i=h/d) | Intrastate (incl. Corrected FCC Dereg Adj C-19) | | Net Change %Intrastate | Intrastate Net Change Ratio |
| | (A) | (B) | (C) | (D) | (E) | (F) | (G) | (H) | (I) | (J) | (K) | (L) | (M) |
| | **REVENUES** | | | | | | | | | | | | |
| 1 | Local Network Service Revenue | $842,673 | $0 | $842,673 | $842,673 | | $0 | $842,673 | 100.0000% | $842,673 | 100.0000% | | |
| 2 | Network Access Service Revenues | 628,781 | 0 | 628,781 | 72,786 | | 0 | 72,786 | 11.5757% | 72,786 | 11.5757% | | |
| 3 | Long Distance Network Service Revenue | 11,160 | 0 | 11,160 | 11,163 | | 0 | 11,163 | 100.0277% | 11,163 | 100.0277% | | |
| 4 | Miscellaneous | 217,861 | | 217,861 | 86,953 | 98,020 | (8,613) | 176,361 | 80.9514% | 89,555 | 41.1064% | | |
| 5 | Total Operating Revenue (L1 thru L4) | 1,700,475 | 0 | 1,700,475 | 1,013,576 | 98,020 | (8,613) | 1,102,984 | 64.8633% | 1,016,177 | 59.7584% | | |
| | **EXPENSES** | | | | | | | | | | | | |
| 6 | Maintenance Expense | 314,282 | 0 | 314,282 | 201,587 | 35,372 | (2,954) | 234,004 | 74.4569% | 201,854 | 64.2270% | -10.2299% | -13.7394% |
| 7 | Engineering Expense | 12,195 | 0 | 12,195 | 8,836 | 9 | (0) | 8,845 | 72.5289% | 8,837 | 72.4631% | -0.0658% | -0.0907% |
| 8 | Network Operations Expense | 72,723 | 0 | 72,723 | 46,464 | 7,840 | (441) | 53,863 | 74.0657% | 46,471 | 63.9017% | -10.1640% | -13.7230% |
| 9 | Network Administration Expense | 1,962 | 0 | 1,962 | 1,417 | 8 | (0) | 1,425 | 72.6279% | 1,417 | 72.2274% | -0.4005% | -0.5514% |
| 10 | Access Expense | 36,517 | 0 | 36,517 | 9,041 | 0 | 0 | 9,041 | 24.7584% | 9,041 | 24.7584% | | |
| 11 | Other | 544 | 0 | 544 | 390 | 7 | (0) | 397 | 73.0672% | 390 | 71.7880% | -1.2792% | -1.7507% |
| 12 | Total Cost of Service & Products (L6 thru L11) | 438,223 | 0 | 438,223 | 267,736 | 43,236 | (3,395) | 307,576 | 70.1871% | 268,011 | 61.1585% | -9.0286% | -12.8636% |
| 13 | Customer Operations Expense | 233,944 | 0 | 233,944 | 164,981 | 29,640 | (6,606) | 188,014 | 80.3673% | 174,407 | 74.5508% | -5.8165% | -7.2374% |
| 14 | Corporate Operations Expense | 235,237 | 20,060 | 255,297 | 179,839 | 23,987 | (11,131) | 192,695 | 75.4789% | 183,224 | 71.7690% | -3.7099% | -4.9151% |
| 15 | Property & Other Taxes | 91,602 | 0 | 91,602 | 66,416 | 1,910 | (1,029) | 67,297 | 73.4666% | 66,510 | 72.6076% | -0.8590% | -1.1692% |
| 16 | Uncollectibles | 24,787 | 0 | 24,787 | 18,119 | 1,271 | 110 | 19,499 | 78.6675% | 18,372 | 74.1214% | -4.5461% | -5.7789% |
| 17 | Total Selling, General & Admin (L13 thru L16) | 585,569 | 20,060 | 605,628 | 429,354 | 56,808 | (18,656) | 467,505 | 77.1933% | 442,513 | 73.0667% | -4.1266% | -5.3458% |
| 18 | Other Operating Income & Expense | (44) | 0 | (44) | (33) | (1) | 0 | (34) | 76.9082% | (33) | 75.4869% | -1.4213% | -1.8480% |
| 19 | Depreciation Expense | 497,353 | 106,528 | 603,881 | 455,903 | 8,523 | (904) | 463,521 | 76.7570% | 456,783 | 75.6413% | -1.1157% | -1.4535% |
| 20 | Universal Service | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0.0000% | 0 | 0.0000% | | |
| 21 | Link Up Americal | 0 | 0 | 0 | (2) | 0 | 0 | (2) | 0.0000% | (2) | 0.0000% | | |
| 22 | Total Operating Expense (L12+L17+L18...L21) | 1,521,101 | 126,587 | 1,647,688 | 1,152,956 | 108,565 | (22,956) | 1,238,565 | 75.1699% | 1,167,271 | 70.8430% | -4.3269% | -5.7562% |
| 23 | **Income From Operations (L5-L22)** | **179,374** | **(126,587)** | **52,787** | **(139,381)** | **(10,545)** | **14,344** | **(135,582)** | | **(151,094)** | | | |
| | **TAXES** | | | | | | | | | | | | |
| 24 | Federal Income Tax | 23,631 | (38,740) | (15,110) | (65,387) | (4,210) | 4,748 | (64,849) | | (69,393) | | | |
| 25 | State & Local Income Tax | 14,910 | (8,314) | 6,596 | (14,123) | (2,194) | 2,725 | (13,592) | | (14,690) | | | |
| 26 | **Net Operating Income (L23-L24-L25)** | **$140,833** | **($79,533)** | **$61,301** | **($59,872)** | **($4,141)** | **$6,871** | **($57,141)** | | **($67,011)** | | | |
| | **RATE BASE** | | | | | | | | | | | | |
| 27 | Telephone Plant In Service | $6,848,171 | ($111,817) | $6,736,354 | $4,781,644 | $105,400 | ($23,574) | 4,863,469 | 72.1974% | $4,797,507 | 71.2182% | -0.9792% | -1.3563% |
| 28 | Short-Term Plant Under Construction | 25,472 | 541 | 26,013 | 19,020 | 237 | (1) | 19,256 | 74.0240% | 19,020 | 73.1168% | -0.9072% | -1.2255% |
| 29 | Materials and Supplies | 24,896 | 0 | 24,896 | 18,036 | 370 | (12) | 18,393 | 73.8810% | 18,079 | 72.6169% | -1.2641% | -1.7110% |
| 30 | Allowance for Cash Working Capital | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0.0000% | 0 | 0.0000% | | |
| 31 | Accumulated Depreciation & Amort. Reserve | 3,728,065 | 331,883 | 4,059,949 | 2,973,385 | 62,384 | (12,669) | 3,023,100 | 74.4615% | 2,981,773 | 73.4436% | -1.0179% | -1.3670% |
| 32 | Accumulated Deferred Income Tax | 505,638 | (167,552) | 338,085 | 202,466 | 5,901 | (1,678) | 206,689 | 61.1352% | 203,054 | 60.0600% | -1.0752% | -1.7587% |
| 33 | Customer Deposits | 3,299 | 0 | 3,299 | 2,363 | 45 | 0 | 2,408 | 72.9946% | 2,408 | 72.9946% | 0.0000% | 0.0000% |
| 34 | Land Development Agreement Deposits | 2,784 | 0 | 2,784 | 2,030 | 0 | 0 | 2,030 | 72.9112% | 2,030 | 72.9112% | 0.0000% | 0.0000% |
| 35 | Other Assets & Liabilites | | 0 | 0 | 0 | 0 | 0 | 0 | 0.0000% | 0 | 0.0000% | | |
| 36 | Net Rate Base | $2,658,752 | ($275,607) | $2,383,145 | $1,638,456 | $37,675 | ($9,240) | $1,666,891 | 69.9450% | $1,645,340 | 69.0407% | -0.9043% | -1.2929% |

**Source:** Qwest workpapers ("az1203.xls" sheet "Interface-1990Financials").

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

MARC SPITZER - CHAIRMAN
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON
KRISTIN K. MAYES

| | | |
|---|---|---|
| IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN | ) ) | DOCKET NO. T-01051B-03-0454 |
| IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS | ) ) ) ) | DOCKET NO. T-00000D-00-0672 |

DIRECT TESTIMONY

OF

THOMAS REGAN

ON BEHALF OF

THE STAFF OF THE ARIZONA CORPORATION COMMISSION

NOVEMBER, 2004

NOTICE: THE PROPRIETARY INFORMATION HAS BEEN REDACTED FROM THIS TESTIMONY.

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## I. STATEMENT OF QUALIFICATIONS AND INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Thomas M. Regan. My business address is 8625 Farmington Cemetery Road, Pleasant Plains, Illinois, 62677.

Q. WHAT IS YOUR PRESENT OCCUPATION?

A. I am an Economist with the firm of William Dunkel and Associates. I have been employed by William Dunkel and Associates since 1994. Since that time, I have regularly provided consulting services in telephone regulatory proceedings throughout the country.

Q. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY IN ARIZONA?

A. Yes. I filed testimony on behalf of the Staff of the Arizona Corporation Commission in the previous general rate case of Qwest in the State of Arizona, Docket No. T-1051-99-105. My testimony in that proceeding discussed economic principles that apply to the calculation of economic costs, and the role that those costs have in telecommunications proceedings.

Q. HAVE YOU PREPARED AN APPENDIX THAT DESCRIBES YOUR QUALIFICATIONS?

A. Yes. My qualifications are shown on Appendix A.

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS PROCEEDING?

A. The purpose of my Direct Testimony in this proceeding is to discuss Qwest's request to draw funds from the Arizona Universal Service Fund (AUSF) and Qwest's proposed rate design in this proceeding.

Q. WILL YOU PLEASE SUMMARIZE YOUR DIRECT TESTIMONY?

A. Yes. My Direct testimony is summarized as follows:

## STAFF'S AUSF "CODE" ANALYSIS:

Qwest's benchmark rates are well in excess of the TSLRICs of basic local service. Therefore, Qwest would not receive any AUSF funding following the requirements of the Code.

Qwest's proposed AUSF analysis calculates a large amount of claimed AUSF support need, due primarily to the fact that Qwest's analysis does not use the properly calculated TSLRIC of basic local exchange telephone service. Qwest's claimed basic local TSLRIC has two major problems:(1) The Administrative Code states:

> **R14-2-1201(14)** "Total Service Long Run Incremental Cost" is the total additional cost incurred by a telecommunications company to produce the entire quantity of a service, **given that the telecommunications company already provides all of its other services.**

Qwest would already be incurring the costs of the loops and ports if Qwest was "already" providing toll, access and vertical services, so those costs are not "additional" costs of basic local exchange service. However Qwest improperly included 100% of these loop and port costs in its claimed basic local TSLRIC.

(2) An additional problem is Qwest has improperly added Network Support costs and common overhead costs to the claimed "TSLRIC" of basic local service, despite the fact that the Code requires the cost to be the TSLRIC only.

**STAFF'S SECOND, OR "OVERALL ANALYSIS" FOR AUSF**

Qwest is not entitled to any AUSF under the Code requirements. However, as a further check to see if Qwest has any reasonable basis for asking for support in certain geographic areas, I also performed a "second analysis", which I refer to as the "overall analysis" of Qwest's intrastate services and intrastate costs. I have performed this additional analysis that compares Qwest's total intrastate revenues to Qwest's total intrastate costs (including the intrastate costs of the loop and port facilities, which are shared by Qwest's major services). Since the "overall analysis" I performed includes all of the intrastate loop costs in the calculation, the "overall analysis" also includes all of the revenues from all of the intrastate services that share the loop facility.

Qwest has asked for support in certain Zone 2 and Zone 3 areas. Even the "overall analysis" indicates that Qwest does not need support to cover its intrastate costs in Zone 2 and Zone 3. ** ** in Zones 2 and 3. For these reasons, I recommend that Qwest's request for AUSF funding be denied.

## RATE DESIGN

For the ** ** intrastate switched access rate elements, Qwest's rates in Arizona are approximately 28% higher than the average rates of Qwest across its 14 state service territory. Qwest's current intrastate switched access charges are approximately ** ** higher than the interstate switched access rates (when the interstate EUCL charges are included in the calculation of the interstate switched access rates). I recommend that Qwest's intrastate switched access rates be reduced by 25%. This reduction will effectively bring Qwest to "parity" with the Qwest interstate switched access rates (when the interstate EUCL charges are factored into the calculation of the interstate switched access rates), and will bring the Arizona intrastate switched access rates in line with the average intrastate switched access charges of Qwest across its 14 state service territory.

I oppose Mr. Teitzel's proposal to eliminate the exchange zone increment 1 and 2 rates. The purpose of the zone increment charges is to recover costs for serving areas that have higher than average costs. The current Zone increment charges are properly serving the purpose of defraying at least part of the costs in high cost areas.

I oppose Qwest's proposal to eliminate the current one free call allowance for Directory Assistance. Qwest has not provided any compelling support for its proposal to eliminate the one free call allowance. In addition, *even* Qwest's proposed "Fully Allocated TSLRIC" of Local Directory Assistance is ** ** per call, whereas the average revenue per local DA call (including free call allowance calls) is ** ** per call. With the current one free call allowance, the current DA rates provide a contribution of over ** ** above Qwest's proposed "Fully Allocated TSLRIC" cost.

I do not oppose Qwest's proposal to eliminate several service packages and custom calling packages that include 2,3,4 or 5 custom calling features. The annual revenue impact of these proposals is an increase of $785,315.

I do not oppose Qwest's proposed changes for Call Management/Centron 1 packages, or Qwest's proposed pricing changes for Centron 6 and Centron 30 packages. The annual revenue impact of these proposals is an increase of $127,335.

I do not oppose Qwest's proposed changes for private line services. The annual revenue impact of these proposals is an increase of $748,000.

I do not oppose Qwest's proposed changes for 800 Database service. The annual revenue impact of these proposals is an increase of $46,000.

The overall annual revenue impact of the rate changes I have proposed in this testimony (including the rate changes proposed by Qwest, which I do not oppose), is ($7,228,420).

## II. THE ARIZONA UNIVERSAL SERVICE FUND (AUSF)

### A. THE AUSF UNDER THE ARIZONA ADMINISTRATIVE CODE

Q. HOW ARE AUSF SUPPORT AMOUNTS TO BE CALCULATED UNDER THE ARIZONA ADMINISTRATIVE CODE?

A. The Arizona Administrative Code states that AUSF support shall be based upon the difference between the "benchmark rates for basic local service" and "the appropriate cost to provide basic local exchange service as determined by the Commission", less any federal USF support. The Code specifically states:

> R14-2-1202. Calculation of AUSF Support
>
> a. The amount of AUSF support to which a provider of basic local exchange telephone service is eligible for a given AUSF support area shall be based upon the difference between the benchmark rates for basic local exchange telephone service provided by the carrier, and the appropriate cost to provide basic local exchange

telephone service as determined by the Commission, net of any universal service support from federal sources.

Q. WHAT MEASURE OF COST DOES THE ARIZONA ADMINISTRATIVE CODE REQUIRE BE USED TO DETERMINE "THE APPROPRIATE COST TO PROVIDE LOCAL EXCHANGE TELEPHONE SERVICE"?

A. For "large local exchange carriers" (i.e. incumbent providers of basic local exchange telephone service serving 200,000 or more access lines in Arizona[1]) like Qwest, the Code requires that "Total Service Long Run Incremental Cost" be used as the appropriate cost standard when determining "the appropriate cost of providing basic local exchange telephone service for purposes of determining AUSF support".[2] The Code specifically states that for a large exchange carrier...

> the appropriate cost of providing basic local exchange telephone service for purposes of determining AUSF support shall be the Total Service Long Run Incremental Cost.[3]

Q. DOES THE ADMINISTRATIVE CODE DEFINE "TOTAL SERVICE LONG RUN INCREMENTAL COST"?

A. Yes. The Administrative Code states:

> **R14-2-1201(14)** "Total Service Long Run Incremental Cost" is the total additional cost incurred by a telecommunications company to produce the entire quantity of a service, **given that the telecommunications company already provides all of its other services.** Total Service Long Run Incremental Cost is based on the least cost, most efficient technology that is capable of being implemented at the time the decision to provide the service is made. (emphasis added)

[1] AAC Section R14-2-1201(12).
[2] AAC Section R14-2-1202(D).
[3] AAC Section R14-2-1202(D).

Q. THE CODE'S DEFINITION OF TOTAL SERVICE LONG-RUN INCREMENTAL COST (TSLRIC) INDICATES THAT TSLRIC IS THE ADDITIONAL COST TO PROVIDE THE SERVICE "GIVEN THAT THE TELECOMMUNICATIONS COMPANY ALREADY PROVIDES ALL OF ITS OTHER SERVICES." WHAT OTHER SERVICES DOES QWEST PROVIDE BESIDES BASIC LOCAL EXCHANGE TELEPHONE SERVICES?

A. In addition to providing basic local exchange services, Qwest also provides intraLATA toll services, intrastate switched access services, interstate switched access services, vertical services (e.g. Caller I.D., Call Waiting, etc.), and other services.

Q. WHAT FACILITIES DOES QWEST NEED TO PROVIDE THESE OTHER SERVICES?

A. In order to provide these other services, Qwest needs a number of facilities, including loop and port facilities. If Qwest "already provides" toll, switched access and vertical services, Qwest would already have incurred the loop facility and port facility costs. Therefore, loop and ports are not "additional costs" incurred to provide basic local exchange service. Therefore, the loop and port costs are not part of the basic local service TSLRIC.

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[4]In this testimony the reference to the loop is to the switched loop or common line. That is the switched loop that is used for services including local, toll, etc. The reference to the loop is not to the private line loop that is a dedicated service (such as a burglar alarm line).

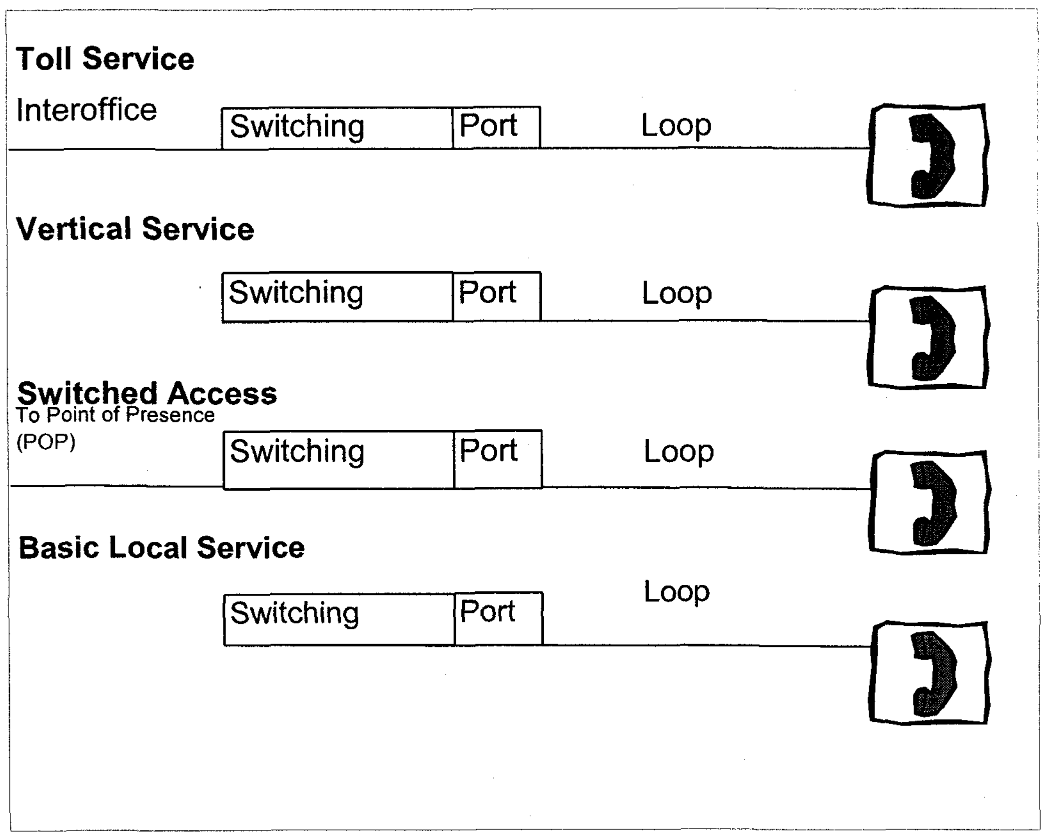
[5]Qwest-Arizona 2003 ARMIS Report 43-04, Loop Circuit Equipment investment; ($776,179,000 (line 1275) + $2,070,789,000 Loop Cable and Wire investment (line 1455) divided by $4,741,883,000 Total Telecommunications Plant In Service (Line 2194) = 60%.

Q. CAN YOU GRAPHICALLY DEMONSTRATE THE FACT THAT THE LOOP AND PORT WOULD BE NEEDED ALREADY "GIVEN THAT THE TELECOMMUNICATIONS COMPANY ALREADY PROVIDES ALL OF ITS OTHER SERVICES"?

A. Yes. Shown below are the facilities that are needed to provide various major services:

**FACILITIES NEEDED TO PROVIDE**

**THE MAJOR TELECOMMUNICATIONS SERVICES**




[6]¶58, Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, CC Docket No. 96-262, FCC 96-488. Examples of the use of the term "common line" include the FCC End User Common Line (EUCL) charge, which is a charge to end users to recover a portion of the common line costs.

A copy of the above diagram is also attached hereto as Schedule TMR-1. The loop facility is needed to provide any or all of the above services. For example, if a company "already provides all of its other services" (toll, vertical services, switched access services), the loop facility would be needed, even if basic exchange service was not provided.[7]

A company providing all of the above services except for basic local exchange service would have loops and ports. Loops and ports are not "additional costs" incurred by providing basic local exchange service, and are therefore not included in the TSLRIC of basic local exchange service.

Q. HAS THE FCC SPECIFICALLY INDICATED THAT THE LOOP FACILITIES ARE REQUIRED TO ORIGINATE AND TERMINATE LONG DISTANCE CALLS?

A. Yes. The FCC found that all of the loop facilities are required to originate and terminate long distance calls. The FCC specifically stated:

> A telecommunications carrier will typically provide these services, together with numerous other telecommunications service, over a single network because the total cost of providing these services on shared facilities, under shared management, is less than the combined cost of providing these services on separate facilities particularly under separate management operations. A substantial portion of these costs of shared facilities and operations are joint and common costs; it is difficult, if not impossible to approximate the actual portion of such costs for which each product or service is responsible. For these types of costs, considerations other than cost causation must prevail in determining how the costs should be allocated among various services. [8]

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[7] Vertical services include services such as Call Forwarding, Call Waiting, Caller ID, etc.
Implementation of §254(k) of the Communications Act of 1934, as amended, Order adopted and released May 8, 1998, Paragraph 8.

And,

> These costs pose particularly difficult problems for the separations process: The costs of such facilities cannot be allocated on the basis of cost-causation principles because **all of the facilities would be required even if they were used only to provide local service or only to provide interstate access services. A significant illustration of this problem is allocating the cost of the local loop**, which is needed both to provide local telephone service as well as to originate and terminal long-distance calls. The current separations rules allocate 25 percent of the cost of the local loop to the interstate jurisdiction for recovery through interstate charges.[9] (emphasis added)

Q. HAS QWEST PREVIOUSLY ACKNOWLEDGED THE FACT THAT THE LOOP FACILITIES ARE REQUIRED TO PROVIDE MANY OF THE TELEPHONE SERVICES THAT QWEST PROVIDES?

A. Yes. In the last rate case of Qwest in Arizona, a witness testifying on behalf of Qwest stated:

> There is no denying the fact that the local loop is required within a wireline network to deliver *any* wireline service.[10] (emphasis in original)

Obviously, if it is to be assumed that "the telecommunications company already provides all of its other services", as required by the Code's definition of Total Service Long Run Incremental Cost (TSLRIC), Qwest would already need to have loop facilities to deliver those services. Quite simply, Qwest would be unable to provide its major "other services"

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[9] ¶23, *FCC Access Charge Reform Order*, FCC 97-158.

[10] Arizona Docket No. T-01051B-99-0105, Rejoinder Testimony of Dr. William E. Taylor, page 21, lines 15-16.

without already having the loop facilities. Without loop facilities, Qwest would be unable to deliver its major "other services" to its customers.

Q. WHAT ADDITIONAL COSTS WOULD BE INCURRED TO PROVIDE BASIC LOCAL EXCHANGE TELEPHONE SERVICE, ASSUMING THAT QWEST "ALREADY PROVIDES" ALL OF ITS OTHER SERVICES?

A. The only additional costs that would be incurred to provide basic local exchange telephone service (given that Qwest provided all of its other services) would be the costs of local usage, and some other minor costs (e.g. incremental billing and collection costs and directory listing costs). These costs amount to approximately ** ** per line, per month for residence and ** ** per line, per month for business. The calculation of these costs is shown on Schedule TMR-2.

Since Qwest's other services such as toll, switched access, vertical services and other services, require loop and port facilities, Qwest would incur the costs of the loop and port facilities to provide those other services. Qwest would not incur any additional loop and port facilities costs if basic local exchange telephone service is also provided along with the family of services provided using those loop and port facilities. Therefore, the costs of the loop and port facilities are <u>excluded</u> in the proper calculation of the TSLRIC of basic local exchange telephone service.

Q. YOU INDICATED THAT THE ARIZONA ADMINISTRATIVE CODE STATES THAT AUSF SUPPORT FOR QWEST SHALL BE BASED ON THE DIFFERENCE BETWEEN THE "BENCHMARK RATES FOR BASIC LOCAL SERVICE" AND THE TSLRIC OF BASIC LOCAL SERVICE.[11] DOES THE CODE DEFINE THE ""BENCHMARK RATES FOR BASIC LOCAL SERVICE"?

A. Yes. The Code provides the following definition:

> **R14-2-1201(7)** "Benchmark rates" for a telecommunications services provider are those rates approved by the Commission for that provider for basic local exchange telephone service, plus the Customer Access Line Charge approved by the Federal Communications Commission.

Q. WHAT ARE QWEST'S BENCHMARK RATES UNDER THE CODE?

A. Qwest's residential basic local exchange telephone service (i.e. 1FR service) rate is $13.18, and the FCC residential Customer Access Line Charge (CALC) is $6.50.[12] Therefore Qwest's residential benchmark rate is $19.68. Qwest's business basic local exchange telephone rate (i.e. 1FB) is $30.40, and the FCC business CALC is $6.53.[13] Therefore, the business benchmark rate is $36.93.

Q. WOULD QWEST RECEIVE ANY AUSF FUNDING FOLLOWING THE CODE?

[11] Less any Federal USF Support.
[12] Million Direct Testimony Exhibit TKM-2.
[13] Million Direct Testimony Exhibit TKM-2.

A. No. Under the Code, AUSF support for Qwest is based on the difference between the benchmark rates for basic local service and the TSLRIC of basic local service.

Qwest's benchmark rates are well in excess of the TSLRICs of basic local service. This is shown below:

| | Benchmark Rates | TSLRICs |
|---|---|---|
| Residence Basic Local Service | $19.68 | ** ** |
| Business Basic Local Service | $36.93 | ** ** |

The calculation of the TSLRIC costs above is shown on Schedule TMR-2.

## B. QWEST'S PROPOSED "TSLRIC" OF BASIC LOCAL SERVICE IS CRITICALLY FLAWED.

Q. QWEST CLAIMS THAT IT SHOULD RECEIVE $64.04 MILLION ANNUALLY FROM THE AUSF.[14] WHY DOES THE QWEST ANALYSIS CALCULATE SUCH A LARGE AMOUNT OF CLAIMED AUSF SUPPORT NEEDED?

A. The Qwest analysis calculates such a large amount of claimed AUSF support need, due to the fact that Qwest's analysis does not use the properly calculated TSLRIC of basic local exchange telephone service. Qwest's claimed basic local TSLRIC has two major problems:

[14] Million Direct Testimony, page 23, line 15.

(1) Qwest included the loop and port costs as being "additional" costs (part of the TSLRIC) of basic local service. However they are not additional costs "**given that the telecommunications company already provides all of its other services.**"

Qwest would already be incurring the costs of the loops and ports if Qwest was "already" providing toll, access and vertical services, so those costs are not "additional" costs of basic local exchange service. However Qwest improperly included 100% of these loop and port costs in its claimed basic local TSLRIC.

(2) An additional problem is Qwest has improperly added Network Support costs and common overhead costs to the claimed "TSLRIC" of basic local service, despite the fact that the Code requires the cost to be the TSLRIC only.

Therefore, Qwest's proposal to include loop, port, shared and common costs in the local basic service TSLRIC in the AUSF analysis is in direct violation of the Code's definition of TSLRIC.

Q. ONE OF THE COSTS THAT QWEST INCLUDES IN ITS "FULLY ALLOCATED COST" IS WHAT QWEST CALLS THE "DIRECT COST". DOES QWEST CLAIM THAT ITS CLAIMED "DIRECT COST" IS EQUIVALENT TO THE TSLRIC?

A. Yes. One of the cost components that Qwest includes in its proposed "fully allocated cost" is what Qwest calls the "direct" cost. Qwest claims that its proposed "direct cost" is equivalent to the TSLRIC. Qwest's witness, Ms. Million, makes this fact clear beginning on page 9 of her Direct testimony:

> Studies are useful in determining whether the direct revenues associated with a service will cover the direct forward-looking costs associated with the service. That is, the Commission rules require the revenues for a service or group of services to cover the **direct costs (i.e., TSLRIC)** of the facilities, components or capabilities used to provision the service or services. (emphasis added)

## C. QWEST IMPROPERLY INCLUDES ALL OF THE LOOP FACILITY AND PORT FACILITY COSTS IN WHAT QWEST CALLS THE "TSLRIC" OF BASIC LOCAL SERVICE.

Q. DOES QWEST'S PROPOSED TSLRIC OF BASIC LOCAL SERVICE HAVE CRITICAL FLAWS?

A. Yes. Qwest's proposed "direct" cost (TSLRIC) includes 100% of the loop facility costs, and includes 100% of the port facilities costs. The loop and port facilities are facilities that Qwest must have to provide its other major services. As shown on Schedule TMR-1, the loop and port facilities are required to provide any of Qwest's major services. Without the loop and port facilities, Qwest could not deliver toll calls to and from its customers. Without the loop and port facilities, Qwest could not deliver vertical features to its end-users. Without the loop and port facilities, Qwest could not provide IXCs with switched access services. Therefore, all of the costs of the loop and port facilities would have to be incurred in order for Qwest to provide all of its other services. The loop and port facility costs are examples of costs that are shared among the whole family of Qwest's major services. Qwest would not incur any additional loop and port costs to provide basic local exchange telephone service if Qwest was already providing all of its other services. Therefore, the costs of the loop and port facilities are not properly included in the TSLRIC. Qwest made a critical violation of the Code's definition of TSLRIC when it included the full costs of the loop and port facilities in its claimed "direct cost" (i.e., TSLRIC) of basic local service. Qwest's proposal to be granted AUSF funding in this proceeding is based upon Qwest's violation of this definition.

Q. DOES QWEST'S PROPOSAL TO INCLUDE 100% OF THE COSTS OF THE LOOP IN ITS CLAIMED COST OF BASIC LOCAL EXCHANGE SERVICE VIOLATE THE ORDERS OF THE COMMISSIONS IN NUMEROUS STATES?

A. Yes. A number of states have found that the loop is a shared/joint/common cost, and that it is not a cost of just basic local exchange telephone service. Here are some examples:

The Indiana Utility and Regulatory Commission (IURC) specifically found that assigning 100% of the loop cost to one service would violate Section 254(k) of The Telecommunications Act of 1996. It found the loop is "included in the definition of common and joint costs." The IURC found that,

> For purposes of resolving 'takings' claims and 'a reasonable share of the joint and common costs of facilities used to provide those services,' the loop must, therefore, be included in the definition of common and joint costs in order to determine confiscation claims and to be in compliance with the second sentence of Section 254(k). We find that the direct assignment of 100 percent of the loop costs to any one service would be a violation of the second sentence of Section 254(k).[15]

In the State of Utah, the Commission specifically found fault with Qwest's calculation of TSLRIC, because Qwest assigned all of the costs of the access line (i.e. loop) to basic residential service:

> We are troubled by the Company's failure to take into account Commission past orders which deal with some of the pivotal issues and assumptions which go into the calculation of TSLRIC. One failure, in particular, is the Company's decision to assign all costs of access lines to basic residential service...The Commission has already rejected the Company's premise that the only purpose of access lines, the local loop, is for the customer to obtain a dial tone or local service. Without the local loop, the end user would not have access to switched access products or use of toll services.[16]

[15]Indiana Utility Regulatory Commission Order, Cause No. 40785, Section V.(C) Common and Joint Costs, Issued October 28, 1998.

[16]US West Communications, Inc Docket No. 95-049-05, Report and Order, page 95 (Issued November 6, 1995).

Similarly, in the State of Iowa, the Utilities Board found that Qwest's (then U S WEST) LRIC methodology was flawed due to the fact that Qwest assigned all of the costs of the loop to local service:

> Designating the access line as a separate service and allocating all of its costs to the local service customer continues to be a major problem with U S WEST's LRIC methodology.[17]

The Washington Utilities and Transportation Commission found:

> Finally, the residential cost study contains a basic flaw: USWC improperly allocates 100% of the local loop to residential service, and 0% to services that rely and depend on the use of that facility. The Commission in the past has addressed this issue and found it appropriate to allocate a portion of the loop costs to toll and other services.[18]

The Colorado Public Utilities Commission found:

> The second argument defines the local loop as a system. This system has many different users demanding service, including residential customers; small, medium and large businesses; governmental bodies; resellers; long distance companies; and others. A local loop is required and used by all of these users. Consequently, it has value to all of these users, and all should pay a portion of customer access.[19]

The New Hampshire Public Utilities Commission found:

> The commission is well aware of the company's claim that basic local exchange service has been and continues to be subsidized by toll. In the past, the notion of various services contributing to the support of basic exchange has been reinforced by cost studies that have served to demonstrate that the 'contribution' paid by customers of

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[17]US West Communications, Inc., Docket No. RPU-94-1, Final Decision and Order, p. 13 (IUB Nov. 21, 1994).

[18]US West Communications, Inc. Docket No. UT-941464 et al, Fourth Supplemental Order at 39. (WUTC Oct. 1995)

[19]Page 19, Colorado Public Utilities Commission Order, I&S Docket No. 1720, dated March 20, 1987.

> other services represents a disproportionately greater share of the company's incurred costs. These studies have served to mislead due to the company's decisions to assign NTS costs to local exchange services despite the fact that both interstate and state toll services are provided over local NTS facilities. Without local exchange facilities there would be no mechanism to connect interexchange services to the majority of customers premises. Since clearly the availability of the local network for toll use is a benefit to interexchange carriers and all toll customers, the Commission believes that assignment of NTS costs solely to local exchange services is unreasonable.[20]

Q. WHAT HAS NARUC STATED?

A. The general position of most of the state commissions is summarized by the National Association of Regulatory Utility Commissioners' (NARUC) statement,

> Interexchange carriers should pay a portion of the NTS loop cost because they use the LECs loop to provide their services.[21]

Q. ARE THE LOOP AND PORT FACILITIES COSTS A LARGE PORTION OF QWEST'S PROPOSED COST OF BASIC LOCAL EXCHANGE TELEPHONE SERVICE?

A. Yes. The majority of Qwest's proposed cost of basic local exchange telephone service in the Qwest-proposed AUSF analysis is the costs of the loop and port facilities. For example, as shown on page 1 of Ms. Million's Direct Testimony Schedule TKM-2, Qwest's claimed "Fully Allocated TSLRIC" cost of 1FR service (flat rate basic local exchange telephone service) in Zone 3 is ** **. Included in this amount is a cost of

[20] Pages 39-40, New Hampshire Public Utilities Commission Order, Docket No. DR-89-010, dated March 11, 1991.

[21] Page 13, Initial Comments of the National Association of Regulatory Utility Commissioners, CC Docket No. 96-262, January 29, 1997.

** ** for the loop facility and ** ** for the port facility.[22] Therefore, over ** ** of the costs that Qwest has included in its cost of basic local exchange telephone service are the costs of the loop and port facilities. Quite simply, over ** ** of the costs that Qwest has included in its proposed cost of basic local exchange telephone service are not properly included in the calculation of the Total Service Long Run Incremental Cost of basic local exchange service. This means that over ** ** of the costs that Qwest has included in its AUSF analysis are not properly included in the AUSF analysis under the requirements of the Code.

Qwest's own figures show that the TSLRIC of residential basic local exchange service (1FR) is ** **, other than the loop and port costs which Qwest improperly included.[23]

## D. <u>QWEST IMPROPERLY PROPOSES TO ADD ADDITIONAL COSTS TO ITS CLAIMED TSLRIC OF BASIC LOCAL SERVICE IN ITS AUSF ANALYSIS</u>

Q. WHAT COST DOES QWEST USE FOR BASIC LOCAL EXCHANGE TELEPHONE SERVICE IN ITS PROPOSED AUSF CALCULATION?

[22] This is shown on Schedule TMR-7, which is a copy of a page from Qwest's cost study that calculates Qwest's proposed "Fully Allocated Cost" of 1FR basic local exchange telephone service.
[23] See Schedule TMR-7, page 2 of 2, line 26.

A. On page 24 of her Direct Testimony, Ms. Million indicates that she used "Qwest's fully allocated cost to calculate the amount of AUSF support necessary." On page 11 of her Direct testimony, Ms. Million explains that Qwest's "fully allocated costs" are the sum of three separate cost components: (1) what Qwest claims is Direct cost/TSLRIC, (2) Network Support costs and (3) common overhead costs. Ms. Million specifically states:

> Qwest's cost models all employ the same basic procedures to arrive at monthly recurring Total Direct or TSLRIC, Network Support and common overhead cost estimates that make up the fully allocated costs.

As demonstrated in the quote above, Qwest has improperly proposed to add additional "Network Support" and "common overhead" costs to its claimed "TSLRIC" of basic local service, despite the fact that the Code requires the cost to be the TSLRIC only.

Q. THE CODE REQUIRES THE TSLRIC TO BE USED IN THE AUSF ANALYSIS. WHY IS QWEST PROPOSING TO USE ITS CLAIMED "FULLY ALLOCATED COST", INSTEAD OF THE TSLRIC AS REQUIRED UNDER THE CODE?

A. According to Qwest's witness Ms. Million, Qwest is using its claimed "fully allocated cost" because Qwest wants to use a cost that includes not only the TSLRIC, but also includes costs that are "shared among groups of services" and includes "common overhead costs". On page 24, lines 10-16 of her Direct testimony, Ms. Million states:

> [T]he total cost to provide a retail service includes the direct cost of the service, the costs that are shared among groups of services and a contribution to the common overheads of the corporation. If the AUSF support were calculated using an amount that recovered less than the total cost to provide the service, then the shared costs as well as the amount of contribution to common overheads from basic local exchange service would be borne entirely by the lines located in Zone 1.

On page 25, lines 6-7 of her Direct testimony, Ms. Million states:

> Therefore, the appropriate cost to use in calculating the AUSF support amount is Qwest's fully allocated cost.

Q. DOES QWEST ACKNOWLEDGE THE FACT THAT THE TSLRIC DOES NOT INCLUDE SHARED COSTS OR COMMON OVERHEAD COSTS?

A. Yes. Beginning on page 19, line 16, Ms. Million states:

> In contrast, Qwest's TSLRIC results include only the direct costs for each of the single services, whereas the costs which are shared among services and the common costs result in what is referred to as the fully allocated cost.

Q. QWEST IS PROPOSING TO USE WHAT IT CALLS THE "FULLY ALLOCATED COST" OF BASIC LOCAL EXCHANGE TELEPHONE SERVICE IN ITS AUSF ANALYSIS. IS QWEST'S PROPOSED COST CONSISTENT WITH THE AUSF REQUIREMENTS OF THE CODE?

A. No. As already discussed, the Code requires that the "Total Service Long Run Incremental Cost" be used in the AUSF analysis. Section R14-2-1201(14) of the Code defines the Total Service Long Run Incremental

Cost as the total additional cost incurred by a telecommunications company to produce the entire quantity of a service, given that the telecommunications company already provides all of its other services.

Q. WHAT MAJOR PROBLEMS NEED TO BE ADDRESSED IN THE QWEST PROPOSED AUSF ANALYSIS, IN ORDER FOR A REASONABLE COMPARISON OF TOTAL INTRASTATE REVENUES TO TOTAL INTRASTATE COSTS TO BE MADE?

A. Qwest's proposed USF analysis improperly includes 100% of the loop and port facilities. Specifically, with reference to Qwest's proposed USF calculations shown on Exhibit TKM-2, the figures shown in the "Cost" column of that Exhibit include 100% of the unseparated loop facilities, and 100% of the cost of the unseparated port facilities.[24] This poses two significant problems.

First of all, the FCC-State Joint Board Part 36 rules allocate 25% of the loop facility costs to the interstate jurisdiction, and 75% to the intrastate jurisdiction.[25] Therefore, only 75% of the loop costs should even be considered in this intrastate proceeding. In addition, the USF being addressed in this proceeding is the intrastate USF. Therefore, it would be appropriate to determine Qwest's intrastate

[24] This can be determined by comparing the figures in the "cost" column on Exhibit TKM-02 to the "Fully Allocated TSLRIC" figures that appear on Qwest's residential basic exchange service cost study provided in response to Data Request WDA 2-21, Attachment B, filename "AZRCBXZ204", tab "WINPC3 Output (RES).
[25] Part 36.154(c).

USF needs based upon the difference between Qwest's intrastate revenues and intrastate costs.

Secondly, if all of the <u>intrastate</u> loop costs are going to be included in the calculation, then all of the revenues from all of the <u>intrastate</u> services that share the loop facility must also be included in the calculation. Despite the fact that Qwest included 100% of the unseparated loop costs and 100% of the port facility costs in its proposed AUSF analysis, Qwest limited the revenues to just basic local exchange revenues and the interstate end user common line (EUCL)[26] in its analysis.[27]

Q. WHY WOULD IT BE REASONABLE TO INCLUDE THE INTRASTATE COSTS OF THE LOOP AND PORT FACILITIES IN THE OVERALL ANALYSIS, AS LONG AS THE TOTAL INTRASTATE REVENUES ARE ALSO INCLUDED?

A. The loop and port facilities are shared by a whole family of services, including toll, switched access, vertical features and basic local service. The revenues from the whole family of services contribute to the costs of the loop and port facilities that all of these services share and depend upon. As long as the "overall" analysis includes the revenues from all of the services that share the loop and port facilities, it is appropriate to include the costs of the loop and port facilities that all of the services share.

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[26] The EUCL is also commonly referred to as the Subscriber Line Charge (SLC).
[27] Million Direct Testimony Exhibit TKM-02.

In contrast, the Qwest proposed AUSF analysis includes all of the shared costs of the loop and port facilities, but does not include all of the revenues from the services that share and contribute to the cost of the loop and port facilities. Therefore, Qwest's proposed analysis is a one-sided analysis that includes all of the shared costs of the loop and port facilities, but excludes the revenues from many of the services that contribute to the costs of the loop and port facilities.

## E. ADDITIONAL STAFF AUSF ANALYSIS, COMPARING ALL INTRASTATE REVENUES TO ALL INTRASTATE COSTS

Q. MS. MILLION STATES THAT QWEST WOULD LIKE TO CALCULATE ITS AUSF FUNDING NEEDS USING A COST THAT INCLUDES "COSTS THAT ARE SHARED AMONG GROUPS OF SERVICES" AND "COMMON OVERHEAD" COSTS.[28] HAVE YOU PERFORMED AN ALTERNATIVE ANALYSIS FOR AUSF FUNDING THAT USES TOTAL COSTS?

A. Yes. In a prior section, I discussed the fact that Qwest would not receive any AUSF funding following the Code's AUSF rules, because Qwest's basic local service benchmark rates are greatly in excess of Qwest's TSLRICs of providing basic local service. I will refer to the prior analysis as the "Code Analysis". The "Code Analysis" indicates that Qwest should not receive AUSF support, as previously discussed.

[28] Million Direct, page 24, lines 10-16.

As a further check to see if Qwest has any reasonable basis for asking for AUSF support, I also performed a "second analysis", which I will refer to as the "overall analysis" of Qwest's intrastate services and intrastate costs. The "overall analysis" includes residential and small business lines. The "overall analysis" does not include large business services like Centrex.

I do believe that a reasonable AUSF calculation could be performed by comparing the total intrastate revenues per line (including local, toll, switched access, vertical services, etc.) to the total intrastate cost of providing telecommunications services (including the costs of shared facilities).

Q. COULD YOU PLEASE DESCRIBE THE "OVERALL ANALYSIS" YOU PERFORMED, IN GENERAL TERMS?

A. Yes. In my analysis, I compared the total intrastate revenues to the total intrastate costs, separately by each Zone (i.e. Zone 1, Zone 2 and Zone 3). The analysis includes both small business and residence services. The analysis does not include large business services like Centrex. The AUSF support amounts are calculated separately for each Zone by comparing the total intrastate revenues to the total intrastate costs in each Zone.

Q. WHAT COSTS DID YOU INCLUDE IN YOUR ANALYSIS?

A. For the loop facility costs, I started with the Commission's approved UNE loop rate for each Zone. I then removed 25% of the UNE loop rates to represent the portion of the loop facility costs that are allocated to the interstate jurisdiction, consistent with the FCC-State Joint Board Part 36 rules.[29]

For the port facility costs, I started with the Commission's approved UNE port rate. The UNE port rate is a statewide average rate. I then removed 17% of the UNE port rate to represent the portion of the port facility costs that are allocated to the interstate jurisdiction, based upon jurisdictional separations. The UNE rates also include common costs, as Ms. Million indicates in her Direct testimony.[30]

I included costs for basic local usage, billing and collection and directory listings.

In addition, since this analysis includes the revenues for intrastate switched access, intrastate toll and vertical features, I also included additional costs for switched access, toll and vertical features costs. For purposes of the additional costs of basic local usage, billing and collection, directory listings, intrastate switched access, intrastate toll and vertical features, I used the "Fully Allocated TSLRIC" costs provided by Qwest in this proceeding. As I have already discussed, Qwest's proposed "fully allocated" costs include "Network Support" and common overhead costs. For some services, the costs vary by zone. Each of these costs are reflected as per-line costs in my analysis provided on Schedule TMR-3.

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[29] Part 36.154(c).

[30] Million Direct testimony, page 24, line 21.

Q. WHAT REVENUES DID YOU USE IN YOUR ANALYSIS?

A. The revenues I used in my analysis include the basic local exchange service rate (i.e. 1FR or 1FB rate)[31], zone increment charges, vertical features revenues, intrastate toll revenues and intrastate switched access revenues. The revenues for some services vary by zone. Each of these revenues are reflected as per-line revenues in my analysis provided on Schedule TMR-3.

Q. WHAT ARE THE RESULTS OF YOUR ANALYSIS THAT COMPARES QWEST'S TOTAL INTRASTATE REVENUES TO TOTAL INTRASTATE COSTS BY UNE ZONE?

A. The analysis shows that overall, Qwest's intrastate revenues ** ** Qwest's intrastate costs. Overall, statewide (i.e. Zones 1, 2 and 3), Qwest's total intrastate revenues are ** **. For Zones 2 and 3, Qwest's total intrastate revenues are ** **. The results are summarized on page 2 of Schedule TMR-3.

Q. DOES QWEST RECEIVE REVENUES OTHER THAN FROM BASIC LOCAL EXCHANGE SERVICE?

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[31] The Interstate End User Common Line (EUCL) charge was not included in my analysis. Only intrastate costs and intrastate revenues were included in the analysis.

[32] This can be determined by comparing the figures in the "cost" column on Exhibit TKM-02 to the "Fully Allocated TSLRIC" figures that appear on Qwest's residential basic exchange service cost study provided in response to Data Request WDA 2-21, Attachment B, filename "AZRCBXZ204", tab "WINPC3 Output (RES).

[33] Part 36.154(c).

[34] The EUCL is also commonly referred to as the Subscriber Line Charge (SLC).

[35] Million Direct Testimony Exhibit TKM-02.

A. Yes. The comparison below demonstrates that the residential basic exchange service rate is by no means the only intrastate revenue that Qwest receives when it provides telephone service to a residential customer. A comparison of the residential intrastate revenues and residential intrastate costs is shown below for Zone 2 and Zone 3:

**

[36] This figure is calculated using Qwest's proposed "Fully Allocated TSLRIC" costs. This figure includes ** ** of billing and collections costs.

[37] The total Qwest proposed "Fully Allocated TSLRIC" billing and collections costs per line are ** ** per line, per month, as shown on Schedule TMR-7. However, I have included ** ** of billing and collections costs in the 1FR cost shown above.

**

The above figures are also shown on page 1 of Schedule TMR-3, attached hereto.

Quite simply, Qwest receives a lot more revenue than just the basic local exchange service rate when it provides telephone service to an end user. For example, as shown above and on page 1 of Schedule TMR-3, the residential basic local exchange service rate represents ** ** of the revenues that Qwest receives when it serves a residential customer in Zone 3.

Q. AT ONE TIME, DID THE FCC CONSIDER DETERMINING FEDERAL USF NEEDS BY COMPARING THE TOTAL COSTS TO TOTAL REVENUES?

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[38]This figure is calculated using Qwest's proposed "Fully Allocated TSLRIC" costs. This figure includes ** ** of billing and collections costs.

[39] The total billing and collections costs per line are ** ** per line, per month, as shown on Schedule TMR-3. However, I have included ** ** of billing and collections costs in the 1FR cost shown above.

A. Yes. At one time, the FCC did consider determining Federal USF needs by comparing a carrier's costs to a "revenue benchmark".[40] The "revenue benchmark" that the FCC was going to use did not just include basic local service revenues. The FCC's benchmark also included the revenues for switched access services and vertical services. Both the FCC-State Joint Board[41] and the FCC properly concluded that since the cost they calculated included the shared loop facilities costs, the revenue benchmark should include the revenues from the <u>family</u> of services that share the loop facilities:

> As the Joint Board recommended, the revenue benchmark should take account not only of the retail price currently charged for local service, but also of other revenues the carrier receives as a result of providing service, including vertical service revenue and interstate and intrastate access revenues. Failure to include all revenues received by the carrier could result in substantial overpayment to the carrier.[42]
>
> We include revenues from discretionary services in the benchmark for additional reasons. ... Revenues from services in addition to the supported services should, and do, contribute to the joint and common costs they share with the supported services.[43]

The FCC never did implement the Federal USF calculation that compared cost to revenues, but when it was preparing to use that standard, the FCC properly recognized the concept that this cost had to be compared to revenues from the <u>family</u> of services which shared the loop (including switched access service

[40] Currently, the FCC uses its Proxy Model cost results for a company to compare to other <u>costs</u>, not rates. Under the FCC's current USF, a carriers' disbursements from the Federal USF depend on the carriers' costs relative to the national average <u>cost</u> of serving customers. See §36.631(c) of the FCC's Rules.
[41] The FCC-State Joint Board is made up of both state commissioners and FCC commissioners.
[42] Report and Order in CC Docket No. 96-45, FCC 97-157, Released May 8, 1997, ¶200.
[43] Report and Order in CC Docket No. 96-45, FCC 97-157, Released May 8, 1997, ¶261.

revenues and vertical services revenues), not compared to just basic exchange revenues.

Q. DOES QWEST CURRENTLY RECEIVE ANY FEDERAL HIGH COST LOOP SUPPORT IN ARIZONA?

A. No. Under the Federal high cost loop system currently in place, Qwest does not receive any Federal high cost loop support in Arizona.[44]

Q. WHAT DO YOU CONCLUDE?

A. I conclude that Qwest's request for the Zone 2 and Zone 3 AUSF support should not be granted. The "Code Analysis" shows that Qwest would not receive any AUSF funding following the Code's AUSF rules, because Qwest's basic local service benchmark rates are greatly in excess of Qwest's TSLRICs of providing basic local service.

Qwest's proposed AUSF analysis improperly includes the costs of the shared loop and port facilities. Over ** ** of the costs that Qwest has included in its "Fully Allocated Cost" of basic local exchange telephone service are not properly included in the calculation of the Total Service Long Run Incremental Cost of

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[44] Universal Service Administrative Company, Federal Universal Service Support Mechanisms Fund Size, Projections for the First Quarter 2005, Appendix HC01, November 2, 2004.

[45] Part 36.154(c).

[46] Million Direct testimony, page 24, line 21.

[47] The Interstate End User Common Line (EUCL) charge was not included in my analysis. Only intrastate costs and intrastate revenues were included in the analysis.

basic local exchange service, and are therefore not properly included in the AUSF analysis under the requirements of the Code.

My second, or "overall analysis" indicates that Qwest does not need AUSF support to cover its intrastate costs in Zone 2 and Zone 3. ** ** in Zones 2 and 3. For these reasons, I recommend that Qwest's request for AUSF funding be denied.

## III. RATE DESIGN

### A. ZONE INCREMENT CHARGES

Q. ON PAGE 86 OF HIS DIRECT TESTIMONY, MR. TEITZEL PROPOSES TO ELIMINATE THE EXCHANGE ZONE INCREMENT 1 AND 2 RATES, WHICH ARE PRICED AT $1.00 AND $3.00 RESPECTIVELY. DO YOU SUPPORT MR. TEITZEL'S PROPOSAL?

A. No. I do not support Mr. Teitzel's proposal.

The purpose of the zone increment charges is to recover costs for serving areas that have higher than average costs. Mr. Teitzel makes this point clear on page 87 of his Direct Testimony, when he provides the following Q & A:

> Q. HAVE LOCAL SERVICE ZONE INCREMENTS BEEN A MEANS FOR QWEST TO RECOVER COSTS FOR SERVING AREAS THAT ARE, ON

> AVERAGE, MORE COSTLY TO SERVE THAN OTHER AREAS OF THE STATE?
>
> A. Yes. The Zone 2 increments have been assessed to customers that are in the highest cost areas of Qwest's service territory, while the Zone 1 increments are applicable to areas that have local exchange costs that are slightly higher than average.

Therefore, the current Zone increment charges are properly serving the purpose of defraying at least part of the costs in high cost areas.

## B. SWITCHED ACCESS

Q. ON PAGE 14, LINE 14 OF HIS DIRECT TESTIMONY, QWEST'S WITNESS MR. MCINTYRE DISCUSSES A $5 MILLION INTRASTATE SWITCHED ACCESS REVENUE REDUCTION. HAS THIS REDUCTION BEEN RESCINDED BY THE COMMISSION?

A. Yes. In Decision 67047, the Commission reversed the $5 million reduction.[48]

Q. ON PAGE 15 OF HIS DIRECT TESTIMONY, MR. MCINTYRE STATES THAT IN THE RECENT PAST, QWEST HAS SUPPORTED LOWERING INTRASTATE SWITCHED ACCESS RATES TO "INTERSTATE LEVELS". WHAT IS THE MAJOR REASON WHY QWEST'S INTERSTATE SWITCHED ACCESS RATES ARE LESS THAN QWEST'S INTRASTATE SWITCHED ACCESS RATES?

A. Qwest's interstate switched access charges are priced artificially low because those interstate rates are supported by the interstate End User Common Line

[48] Decision No. 67047, Dated June 18, 2004, page 7, line 3.

(EUCL) charge that appears on local end-user customers' bills. For residential customers, the interstate EUCL is currently $6.50 per line per month for Qwest in Arizona. Therefore, the interstate switched access charges are artificially suppressed rates, that are supported in part by per-line charges paid for by end-user customers.

Q. HAS THE ARIZONA COMMISSION PROPERLY RECOGNIZED THAT THERE ARE PUBLIC POLICY CONCERNS THAT IMPACT THE COMMISSIONS ABILITY TO SET QWEST'S INTRASTATE SWITCHED ACCESS RATES AT "PARITY" WITH THE QWEST INTERSTATE SWITCHED ACCESS RATES?

A. Yes. In its Order in Qwest's last rate case, Docket No. T-01051B-99-0105 et. al., the Commission stated:

> Although the Settlement Agreement professes a goal of reaching parity between Qwest's intrastate and interstate switched access charges, it does not, at least in its initial three year term reach that goal. It does, however, take a step forward. While we agree that achieving parity between intrastate and interstate switched access rates is a laudable goal, there are many other public policy issues that impact our ability to reach that goal, such as the desirability of imposing an End User Common Line charge. Such decision concerning the structure of toll service charges should occur in a generic docket as it affects more than just Qwest.[49]

Q. CAN YOU PROVIDE A COMPARISON OF QWEST'S CURRENT INTRASTATE SWITCHED ACCESS RATES, TO QWEST'S INTERSTATE SWITCHED ACCESS RATES <u>INCLUDING THE EUCL CHARGE</u>?

[49]Commission Opinion and Order in Docket No. T-01051B-99-0105 et. al, page 12, lines 15-21, October 20, 2000.

A. Yes. In discovery, Qwest provided its current average revenue per minute for intrastate switched access services, which is ** ** per minute.[50]

The average interstate switched access rate, including EUCL, is ** **.[51]

A summary of the results of this analysis is shown below:

**

**

The calculation of the interstate switched access rates shown above is shown on Schedule TMR-4, attached hereto.

Q. WHAT DO YOU CONCLUDE FROM THIS ANALYSIS?

A. The analysis I have performed demonstrates that Qwest's current intrastate switched access charges are approximately ** ** higher than the interstate switched access rates (when the interstate EUCL charges are included in the calculation of the interstate switched access rates).[53]

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[50] In response to other discovery, Qwest provided what its intrastate switched access revenues would be if its switched access rates were set equal to (i.e. at "parity") with Qwest's interstate switched access rates (*not* including the interstate EUCL charge). Those revenues equal ** ** per minute. I then calculated the interstate EUCL charge on a per-minute-of-use basis, by dividing the average monthly interstate EUCL rate by the total monthly interstate switched access minutes of use. On a per-minute-of-use basis, the interstate EUCL charge is ** ** per minute.

[51] ** **.

[52] Qwest response to Data Request WDA 6-2.

[53] ** **.

Q. HAVE YOU PERFORMED ANOTHER ANALYSIS TO HELP ASSESS THE LEVEL OF QWEST'S CURRENT INTRASTATE SWITCHED ACCESS RATES?

A. Yes. In a separate analysis, I compared the current charges for Qwest's ** ** intrastate switched access rates in Arizona, to the average intrastate switched access charges of Qwest for those same services across Qwest's 14 state service territory.[54] This analysis demonstrates that for the ** ** intrastate switched access rates, Qwest's rates in Arizona are approximately 28% higher than the average rates of Qwest across its 14 state service territory. A summary of this analysis is shown below:

**QWEST'S RATES FOR THE ** **

**INTRASTATE SWITCHED ACCESS RATES**

| | Arizona | Qwest 14 State Average[55] |
|---|---|---|
| Carrier Common Line Access Service (CCL) | | |
| Originating | $0.006244 | $0.009255 |
| Terminating | $0.014153 | $0.012329 |
| Local Switching | | |
| Originating | $0.017300 | $0.011177 |
| Terminating | $0.017300 | $0.010197 |
| Tandem Switching | $0.005000 | $0.003980 |
| Total-Originating and Terminating | $0.059997[56] | $0.0469380 |
| Approx. Major Ave.per Access Minute (=Total/2) | $0.029998 | $0.023469 |
| Percent- Arizona/Average | 128% | |

[54] Qwest's ** ** intrastate switched access rates in Arizona are local switching, Carrier Common Line Access Service (CCL), and tandem switching, as shown on page 1 of Schedule TMR-5.

[55] The Carrier Common Line Access Service rates exclude the state of Montana. Montana has a flat-rated CCL that is split among each IXC based on each IXC's relative market share measured in relative share of minutes of use.

[56] The average revenue per minute for Qwest's intrastate switched access in Arizona is ** **.This figure includes access charges in addition to the major charges included in the above analysis. (See Qwest's response to Data Request WDA 6-2).

The calculation of the above figures is shown on page 2 of Schedule TMR-5, attached hereto.

Q. WHAT DO YOU RECOMMEND FOR INTRASTATE SWITCHED ACCESS SERVICES?

A. I recommend that Qwest's intrastate switched access rates be reduced by 25%. The intrastate switched access rates that I propose this reduction for are shown on page 1 of Schedule TMR-5. This reduction will effectively bring Qwest to "parity" with the Qwest interstate switched access rates (when the interstate EUCL charges are factored into the calculation of the interstate switched access rates), and will bring the Arizona intrastate switched access rates in line with the average intrastate switched access charges of Qwest across its 14 state service territory. The Staff's proposed intrastate switched access rates exceed Qwest's proposed TSLRIC costs for each of the switched access services shown on page 2 of Ms. Million's Direct testimony schedule TKM-1.[57]

Q. WHAT IS THE REVENUE IMPACT OF YOUR SWITCHED ACCESS PROPOSAL?

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[57] However, not every switched access rate element is included on Ms. Million's schedule TKM-1. While I recommend that each of Qwest's intrastate switched access rates shown on page 1 of Schedule TMR-5 be reduced by 25%, I do not intend that any rate be below TSLRIC. I reserve the right to modify my proposal in the event that Qwest demonstrates that any of my proposed rates would result in a rate(s) below the TSLRIC cost to provide that service(s).

A. The annual revenue impact of my proposal to reduce Qwest's intrastate switched access rates by 25% is a reduction ** **, as shown on page 1 of Schedule TMR-5.

Q. WHAT REDUCTION IN REVENUES ARE YOU PROPOSING FOR CARRIER COMMON LINE?

A. As shown on page 1 of Schedule TMR-5, I propose a 25% reduction for Qwest's CCL rates, which results in an annual revenue reduction of ** **.

Q. WHAT SERVICE DOES QWEST PROVIDE IN EXCHANGE FOR THE CARRIER COMMON LINE ACCESS SERVICE RATES?

A. The CCL rates are the IXCs' payment for Carrier Common Line Access Service. The IXCs pay the CCL if they want to use Qwest's common line (i.e. loop) facilities to provide intrastate toll services. Carrier Common Line Access Service is described in Qwest's tariff as follows:

> Carrier Common Line Access Service provides for the use of Company common lines by customers for access to end users to furnish intrastate telecommunications service.[59]

Q. IS IT REASONABLE TO CHARGE THE IXCs A CCL FOR USING THE LOOP FACILITIES?

A. Yes. The IXCs receive a great benefit from sharing the loop facilities with basic local exchange service and all of the other services that share the loop facilities.

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[58] Qwest's response to Data Request WDA 2-9, Attachment A.

[59] Qwest Arizona Access Service Price Cap Tariff, Section 3.1 (General Description), page 1, Effective 8-29-01.

Since the IXCs share the loops with other services and other users, the IXCs can use the loops by paying just a fraction of what it would cost the IXCs to construct their own loops. For example, at the current Qwest CCL rates, all of the IXCs combined pay an average of only ** ** per line per month in intrastate CCL charges. This calculation is shown on Schedule TMR-6, attached hereto. In comparison, Qwest's average charge for a UNE loop is $12.12 per month in Arizona.[60] Therefore, under Qwest's current CCL rates, all of the IXCs combined, are only required to pay for ** ** (on average) of what it would cost the IXC to obtain its own loop facilities.[61]

Quite simply, even at the current CCL rates, the IXCs are making a very small percent contribution to the costs of the common line loop facilities that the IXCs depend upon, benefit from and share with other services and other users. I agree with the National Association of Regulatory Commissioners' (NARUC), when it stated:

> Interexchange carriers should pay a portion of the NTS loop cost because they use the LECs loop to provide their services.[62]

**C. DIRECTORY ASSISTANCE**

Q. ON PAGE 97 OF HIS DIRECT TESTIMONY, MR. TEITZEL PROPOSES TO ELIMINATE THE CURRENT ONE CALL FREE ALLOWANCE

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[60] *A Survey of Unbundled Network Element Prices in the United States* (Updated January 2004), conducted by the Public Service Commission of West Virginia, Appendix 3, page 1.

[61] ** ** divided by $12.12 = ** **.

[62] Page 13, Initial Comments of the National Association of Regulatory Utility Commissioners, CC Docket No. 96-262, January 29, 1997.

ASSOCIATED WITH DIRECTORY ASSISTANCE. PLEASE DESCRIBE WHAT IS MEANT BY THE FREE CALL ALLOWANCE?

A. As discussed on page 96 of Mr. Teitzel's Direct testimony, Qwest's customers are currently allowed to place one call per month to "Local Directory Assistance" free of charge.

Q. IS THERE ANY COST-BASED REASON TO ELIMINATE THE ONE FREE CALL ALLOWANCE?

A. No. As shown on page 2 of Ms. Million's Exhibit TKM-01, Qwest's proposed "Fully Allocated TSLRIC" of Local Directory Assistance is ** ** per call. The current annual revenue for local DA is ** **, and the total number of DA calls (including the free call allowance calls) is ** **.[63] Therefore, the average revenue per local DA call (including free call allowance calls) is ** ** per call.[64] This means that with the current one free call allowance, the current DA rates provide a contribution of over ** ** above Qwest's proposed "Fully Allocated TSLRIC" cost.[65]

Q. WHAT ARE SOME OF THE REASONS QWEST PROVIDES FOR WANTING TO ELIMINATE THE ONE FREE CALL ALLOWANCE?

A. According to Mr. Teitzel, he is proposing to eliminate the current call allowance associated with local directory assistance in order to "achieve consistency with the

[63] This is shown in Qwest's recurring priceout provided in response UTI 1-001S1, Revised Confidential Attachment B, Section C6.2.4.
[64] ** ** divided by ** ** equals ** **.
[65] ** ** divided by ** ** equals ** **.

national directory assistance product"[66], to "alleviate customer confusion", to "simplify the service for our customers", as well as to "improve efficiency" and to "enhance the competitive positioning" of Qwest's Directory Assistance service.[67]

Q. WILL ELIMINATING THE ONE FREE CALL ALLOWANCE ALLEVIATE CUSTOMER CONFUSION OR SIMPLIFY THE SERVICE FOR CUSTOMERS?

A. Not necessarily. Many customers benefit from receiving a one call per month free allowance for local DA. To now remove the free call allowance that customers have become accustomed to would not necessarily "alleviate customer confusion", or "simplify the service". It is possible that such a change could very well create customer confusion and complicate the service for customers. Eliminating the free call allowance is not a benefit for customers.

Q. ON PAGES 98-101 OF HIS DIRECT TESTIMONY, MR. TEITZEL CLAIMS THAT THE FREE CALL ALLOWANCE SHOULD BE ELIMINATED BECAUSE THE MARKET FOR DIRECTORY ASSISTANCE HAS BECOME MORE COMPETITIVE SINCE THE CURRENT QWEST PRICE PLAN WAS ADOPTED. ON PAGE 98 OF HIS DIRECT TESTIMONY, MR. TEITZEL CLAIMS THAT ELIMINATING THE FREE CALL ALLOWANCE WILL "ENHANCE THE COMPETITIVE POSITIONING" OF ITS LOCAL DA SERVICE. DOES MR. TEITZEL EXPLAIN HOW ELIMINATING THE FREE

[66] Teitzel Direct, page 97, lines 6-7.
[67] Teitzel Direct, pages 97-98.

CALL ALLOWANCE WILL MAKE QWEST'S LOCAL DIRECTORY ASSISTANCE SERVICE ANY MORE COMPETITIVE IN THE MARKET?

A. No. Mr. Teitzel provided no evidence that eliminating the free call allowance would do anything to improve Qwest's competitive position in the local DA market. In fact, it would seem logical that having a free call allowance would make Qwest a more attractive Directory Assistance provider than a provider that does not offer a free call allowance. It is not clear how eliminating the free call allowance would do anything to improve Qwest's competitive position in the local DA market.

Q. WHAT DO YOU PROPOSE FOR LOCAL DIRECTORY ASSISTANCE?

A. I propose that no changes be made to local DA. I recommend that the current one free call allowance per month for local DA be retained.

## D. SERVICE PACKAGES

Q. ON PAGE 103 OF HIS DIRECT TESTIMONY, MR. TEITZEL PROPOSES TO ELIMINATE SEVERAL OF ITS SERVICE PACKAGES AND CUSTOM CALLING PACKAGES THAT INCLUDE 2, 3, 4 OR 5 CUSTOM CALLING FEATURES. DO YOU OPPOSE MR. TEITZEL'S PROPOSALS TO ELIMINATE THESE SERVICES?

A. No.

Q. WHAT IS THE REVENUE IMPACT OF MR. TEITZEL'S PROPOSALS TO ELIMINATE THESE SERVICES?

A. Eliminating these service offerings results in an annual reduction in revenues. However, Qwest has re-mapped the demand for the services that are being eliminated, to other service offerings that Qwest will continue to provide. The net revenue impact of these proposals (after re-mapping demand to other services), is an annual increase of ** **.[68]

Q. ON PAGES 105-106 OF HIS DIRECT TESTIMONY, MR. TEITZEL PROPOSES CHANGES FOR CALL MANAGEMENT/CENTRON 1 PACKAGE, AND PRICING CHANGES FOR CENTRON 6 AND CENTRON 30 PACKAGES. DO YOU OPPOSE THESE PROPOSED CHANGES?

A. No.

Q. WHAT IS THE REVENUE IMPACT OF MR. TEITZEL'S PROPOSES CHANGES FOR CALL MANAGEMENT/CENTRON 1 PACKAGE, AND PRICING CHANGES FOR CENTRON 6 AND CENTRON 30 PACKAGES?

A. The combined revenue impact of these proposals is an annual increase of ** **.[69]

## E. PRIVATE LINE AND 800 DATABASE

[68] Qwest's response to Data Request WDA 15-5, Attachment A.
[69] Qwest's response to Data Request WDA 15-6, Attachment A.

Q. ON PAGES 1-4 OF HIS DIRECT TESTIMONY, MR. MACINTYRE PROPOSES SEVERAL RATE CHANGES FOR PRIVATE LINE SERVICES, RESULTING IN AN ANNUAL INCREASE IN REVENUE OF $748,000. DO YOU OPPOSE THESE RATE CHANGES?

A. No.

Q. QWEST PROPOSES CHANGES FOR ITS 800 DATABASE SERVICE. DO YOU OPPOSE THESE CHANGES?

A. No. The revenue impact of Qwest's proposal for 800 Database service is very small (a revenue increase of $46,000).[70] I do not oppose the proposed changes.

Q. CAN YOU PLEASE SUMMARIZE THE REVENUE IMPACTS OF YOUR RATE PROPOSALS?

A. Yes. The annual revenue impacts of my rate proposals are shown below:

**

**

| | |
|---|---|
| Total | ($7,228,420) |

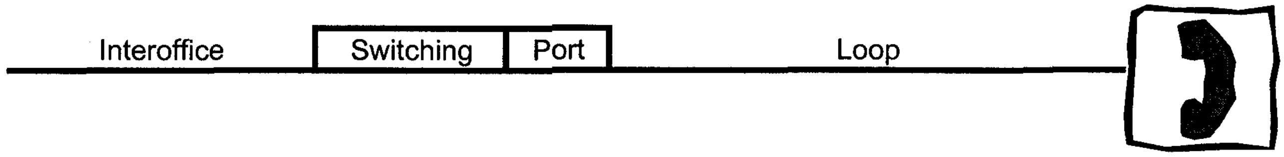
[70] McIntyre Direct Testimony, page 17, line 3.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

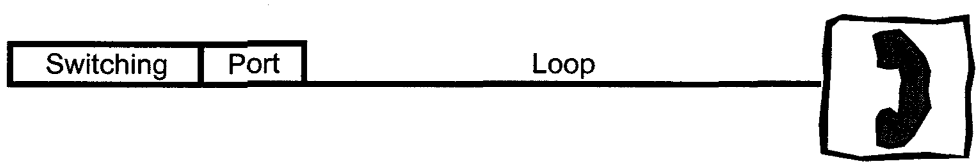
A. Yes.

# FACILITIES NEEDED TO PROVIDE THE MAJOR TELECOMMUNICATIONS SERVICES

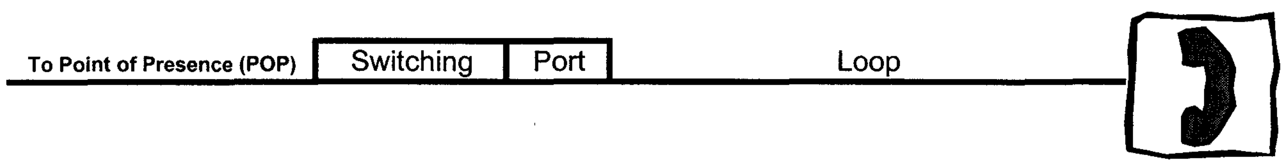
## Toll Service:



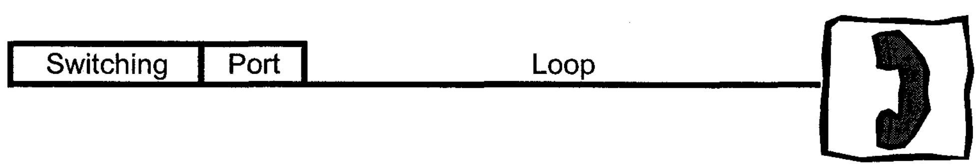

## Vertical Service (e.g. Caller ID, Call Waiting, etc.):




## Switched Access:




## Basic Local Service:



Schedule TMR-2

THIS SCHEDULE CONTAINS INFORMATION DESIGNATED AS CONFIDENTIAL BY QWEST AND HAS BEEN REDACTED FROM THIS PUBLIC FILING.

Schedule TMR-3

THIS SCHEDULE AND WORKPAPERS CONTAIN INFORMATION
DESIGNATEDAS CONFIDENTIAL BY QWEST
AND HAS BEEN REDACTED FROM THIS
PUBLIC FILING.

Schedule TMR-4

THIS SCHEDULE CONTAINS INFORMATION DESIGNATED
AS CONFIDENTIAL BY QWEST
AND HAS BEEN REDACTED FROM THIS
PUBLIC FILING.

THIS SCHEDULE CONTAINS INFORMATION DESIGNATED AS CONFIDENTIAL BY QWEST AND HAS BEEN REDACTED FROM THIS PUBLIC FILING.

# COMPARISON OF INTRASTATE SWITCHED ACCESS CHARGES IN QWEST STATES

RATE PER MINUTE

| ACCESS SERVICE | Colorado | Idaho - North | Idaho - South | Iowa | Minnesota | Montana | Nebraska | New Mexico |
|---|---|---|---|---|---|---|---|---|
| Carrier Common Line Access Service | | | | | | | | |
| Originating | $ 0.009020 | $ 0.021533 | $ 0.015303 | $0.001258 | $ 0.001896 | See Note (1) | $0.00 | $ 0.012259 |
| Terminating | $ 0.020819 | $ 0.029265 | $ 0.020432 | $0.001258 | $ 0.012361 | See Note (1) | $0.00 | $ 0.012259 |
| Local Switching | | | | | | | | |
| Originating | $ 0.012362 | $ 0.014308 | $ 0.016918 | $0.010000 | $ 0.008063 | $ 0.015416 | $0.001968 | $ 0.015822 |
| Terminating | $ 0.012362 | $ 0.014308 | $ 0.016918 | $0.010000 | $ 0.008063 | $ 0.015416 | $0.001968 | $ 0.015822 |
| Tandem Switching | $ 0.005000 | $ 0.004000 | $ 0.002469 | $0.004000 | $ 0.001750 | $ 0.005480 | $0.002545 | $ 0.003423 |
| Total | $ 0.059563 | $ 0.083414 | $ 0.072040 | $0.026516 | $ 0.032133 | $ 0.036312 Plus CCL | $0.006481 | $ 0.059585 |
| Approx. Major Ave.per Access Minute (Total / 2) | $ 0.029782 | $ 0.041707 | $ 0.036020 | $0.013258 | $ 0.016067 | $ 0.018156 | $0.003241 | $ 0.029793 |

| ACCESS SERVICE | North Dakota | Oregon | South Dakota | Utah | Washington | Wyoming | Arizona | Qwest Average |
|---|---|---|---|---|---|---|---|---|
| Carrier Common Line Access Service | | | | | | | | |
| Originating | $ 0.018941 | $0.00 | $ 0.038420 | $0.004700 | $0.00 | $0.00 | $0.006244 | $0.009255 * |
| Terminating | $ 0.018941 | $0.00 | $ 0.038420 | $0.004700 | $0.00 | $0.00 | $0.014153 | $0.012329 * |
| Local Switching | | | | | | | | |
| Originating | $ 0.010566 | $0.004380 | $ 0.008610 | $0.010400 | $ 0.015873 | $0.005664 | $0.017300 | $0.011177 |
| Terminating | $ 0.010566 | $0.004380 | $ 0.008610 | $0.010400 | $ 0.001178 | $0.005664 | $0.017300 | $0.010197 |
| Tandem Switching | $ 0.005734 | $0.003000 | $ 0.007700 | $0.002592 | $ 0.003306 | $0.003705 | $0.005000 | $0.003980 |
| Total | $ 0.064748 | $0.011760 | $ 0.101760 | $0.032792 | $ 0.020357 | $0.015033 | $0.059997 | $0.046938 |
| Approx. Major Ave.per Access Minute (Total / 2) | $ 0.032374 | $0.005880 | $ 0.050880 | $0.016396 | $ 0.010179 | $0.007517 | $0.029999 | $0.023469 |

(1) The CCL in Montana is $2.899 per residence access line, per month, which is split among each IXC based on relative market share, measured in minutes of use. (Section 3.1 through Section 3.2 of Qwest's Montana Access Service Tariff.
* Excludes Montana.

Schedule TMR-6

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Schedule TMR-7

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# 5. EXCHANGE SERVICES

## 5.9 PACKAGED SERVICES

### 5.9.1 PACKAGES ASSOCIATED WITH BASIC EXCHANGE SERVICE

(M)

A. Business *CUSTOMCHOICE* (T)(M1)

1. Description

Business *CUSTOMCHOICE* is a package of features available to business customers in conjunction with an additional or individual flat rate access line. Business customers subscribing to the package are entitled to unlimited use of the services/features specified below:

- Anonymous Call Rejection
- Call Forwarding
  - Busy Line (Expanded)
  - Busy Line (External)
  - Busy Line (Overflow)
  - Busy Line/Don't Answer (Expanded)
  - Busy Line (External)/Don't Answer
  - Busy Line (Overflow)/Don't Answer
  - Busy Line (Programmable)
  - Don't Answer
  - Don't Answer (Expanded)
  - Don't Answer (Programmable)
  - Variable
- Call Transfer
- Call Waiting
- Call Waiting ID
- Caller ID Name and Number
- Calling Connection Plans[1]
  - Minutes Free
- Continuous Redial
- Custom Ringing
- Do Not Disturb
- Hunting
- Last Call Return
- Long Distance Alert
- Message Waiting Indication

[1] For Terms, Conditions, Rates and Charges see 6.3.18 in the Competitive Exchange and Network Services Price Cap Tariff. (M1)

(M) Material moved to 105.9.1.

(M1) Material moved from Page 172.

**5. EXCHANGE SERVICES**

**5.9 PACKAGED SERVICES**
**5.9.1 PACKAGES ASSOCIATED WITH BASIC EXCHANGE SERVICE**

(M)

A.1. (Cont'd) (T)(M1)

- Priority Call
- Remote Access Forwarding
- Selective Call Forwarding
- Scheduled Forwarding
- Speed Call - 8 Number
- Speed Call - 30 Number
- Three-Way Calling
- U S WEST Receptionist - Name & Number

2. Terms and Conditions

   a. A business customer may select an unlimited number of compatible services or features from the list in 5.9.1.A., preceding. All terms and conditions specified elsewhere apply for the respective services/features requested as part of this service. (T)

   b. Existing Business *CUSTOMCHOICE* customers cannot take advantage of promotions for Business *CUSTOMCHOICE* or any of the services/features specified in 5.9.1.A.1., preceding, unless specifically allowed by the terms and conditions of the promotion. (T)

   c. Business *CUSTOMCHOICE* is subject to a minimum billing period of one month.

   d. The Company may withdraw this offering to customers at any time with appropriate notice. (M1)

(M) Material moved to 105.9.1.

(M1) Material moved from Page 173.

Thomas M. Regan, Consultant
8625 Farmington Cemetery Road
Pleasant Plains, IL 62677

**PRESENT POSITION**

William Dunkel and Associates
Position: Consultant

- Filed testimony on behalf of the Missouri Office of Public Counsel before the Missouri Public Service Commission, Case No. TR-2002-251, in which I addressed Sprint's rate rebalancing.
- Filed testimony on behalf of Illinois Attorney General before the Illinois Commerce Commission, Docket No. 02-0864, in which I addressed UNE loop costs and UNE rates.
- Testified on behalf of the Maryland Office of the People's Counsel before the Maryland Public Service Commission in a Universal Service proceeding involving Verizon-Maryland, Case No. 8745.
- Testified on behalf of the Government and Consumers Intervenors (GCI) before the Illinois Commerce Commission in an Alternative Regulation case involving Ameritech Illinois, Docket No. 98-0252, in which I addressed economic principles.
- Filed testimony on behalf of the New Mexico Public Regulation Commission in a subsidy case involving VALOR Communications, Case No. 3300, in which I addressed economic principles.
- Testified on behalf of the New Mexico Public Regulation Commission Staff in a subsidy case involving Qwest Communications, Case No. 3325, in which I addressed economic principles.
- Filed testimony on behalf of the Staff of the Arizona Corporation Commission in a general rate case involving Qwest Communications, Docket No. T-01051B-99-0105, in which I addressed economic principles.
- Filed testimony on behalf of the Pennsylvania Office of Consumer Advocate in a case involving Bell Atlantic-Pennsylvania, Docket No. R-953409 in which he addressed stimulation as a result of toll price reductions.
- Testified on behalf of the Colorado Office of Consumer Counsel in a rate rebalancing case involving U.S. West Communications, Inc., Docket No. 96S-257T et al.
- Testified on behalf of the Utah Committee of Consumer Services in the Residential Price Flexibility case of Qwest in Utah Docket No. 01-2383-01.

- Participated, but did not testify in, the following proceedings:

-Illinois Docket No. 04-0461 (SBC Imputation Requirements)
-Alaska Docket No. R-03-003 (ACS AFOR Proceeding)
-Alaska Docket No. R-01-001 (Access Rate Proceeding)
-Utah Docket No. 03-049-49 (Qwest Price Flexibility-Residential)
-Utah Docket No. 03-049-50 (Qwest Price Flexibility-Business)
-Alaska Docket Nos. U-1-83, U-01-85, U-01-87 (General Rate Proceeding)
-Maryland Case No. 8960 (Washington Gas Light Company Depreciation Rate Proceeding)
-Kansas Docket No. 03-HVDT-664-RTS (Audit and General Rate Proceeding)
-Pennsylvania Docket Nos. C-200271905 (Access Charge Complaint Proceeding)
-Kansas Docket No. 03-WHST-503-AUD (Audit and General Rate Proceeding)
-Illinois Docket No. 02-0864 (SBC UNE Rate Proceeding)
-Pennsylvania Docket Nos. A-310200F0002, A-311350F0002, A-310222F0002, A-310291F0003 (Verizon for Approval of Agreement and Plan of Merger)
-California Docket A.02-01-004 (Kerman General Rate Case)
-Kansas Docket No. 03-S&AT-160-AUD (Audit and General Rate Proceeding)
-Pennsylvania Docket Nos. P-00991649, P-00991648, M-00021596 (Joint Petition for Global Resolution of Telecommunications Proceedings)
-Illinois Docket No. 02-0560 (Verizon Advanced Services Wavier)
-Missouri Docket No. TR-2001-65 (Cost of Access Proceeding)
-Kansas Docket No. 02-JBNT-846-AUD (Audit and General Rate Proceeding)
-Kansas Docket No. 02-BLVT-377-AUD (Audit and General Rate Proceeding)
-Kansas Docket No. 02-S&TT-390-AUD (Audit and General Rate Proceeding)
-Kansas Docket No. 02-WLST-210-AUD (Audit and General Rate Proceeding)
-Kansas Docket No. 02-HOMT-209-AUD (Audit and General Rate Proceeding)
-Kansas Docket No. 01-CRKT-713-AUD (Audit and General Rate Proceeding)
-Kansas Docket No. 01-SFLT-879-AUD (Audit and General Rate Proceeding)
-Kansas Docket No. 01-BSST-878-AUD (Audit and General Rate Proceeding)
-Kansas Docket No. 01-PNRT-929-AUD (Audit and General Rate Proceeding)
-Kansas Docket No. 01-SNKT-544-AUD (Audit and General Rate Proceeding)
-New Mexico Case No. 3223 (Universal service fund proceeding)
-Arizona Docket No. T-00000A-00-0194 (Wholesale cost/UNE proceeding of Qwest)
-Arizona TX 98-00716 (Tax Case of Citizens Telecommunications Company of White Mountain, et. al.)
-Maryland Case No. 8862 (PIC change charge case of Verizon Maryland)
-New Mexico Case No. 3008 (General Rate/Depreciation case of USWest)
-Arizona Docket No. T-01051B-97-0689 (Depreciation case of US West)
-Illinois Docket No. 99-0412 (EAS case involving Geneseo Telephone Company)
-Kansas Docket No. 98-SWBT-677-GIT (State USF case involving SWBT)
-Kansas Docket No. 00-UTDT-455-GIT (State USF case involving Sprint)
-Arizona Docket No. T-02724A-00-0595 (Earnings Review of Table Top Telephone Co.)
-Missouri Docket No. TO-98-329 (USF case involving SWBT)

-Ohio Docket No. 97-1657-TP-UNC (Access charge case involving Ameritech Ohio)
-Illinois Docket Nos. 98-0200/98-0537 (Consolidated) (Usage sensitive service of GTE)
-Florida Undocketed Special Project (Fair and Reasonable Rates of BellSouth, GTE, and Sprint)
-Pennsylvania Docket No. A-310125F002 (GTE North Interconnection Proceeding)
-Washington Docket UT-960369 (US West Communications, Inc. Interconnection Case)
-Utah Docket No. 97-049-08 (US West Communications, Inc. General Rate Case)
-Oklahoma Cause No. PUD 96-0000214 (Public Service of Oklahoma Depreciation Case)
-Hawaii Docket No. 7702 (GTE Hawaiian Tel General Rate Case)
-Washington Docket UT-950200 (US West Communications, Inc. General Rate Case)
-Pennsylvania Docket R-00953409 (Bell Atlantic Toll Automatic Savings Plan)
-Pennsylvania Docket R-00963550 (Bell Atlantic Rate Rebalance Proceeding)
-Iowa Docket RPU-95-11 (US West Communications, Inc. General Rate Case - Withdrawn by USWC just prior to hearings)
-Arizona Docket E-1051-93-183 (US West Communications, Inc. General Rate Case - Remand)
-Colorado Docket 95S-523T (US West Communications, Inc. CustomChoice Case - Withdrawn)
-Utah Docket 95-049-05 (US West Communications, Inc. General Rate Case)
-Iowa Docket RPU-95-10 (US West Communications, Inc. Interconnection Case)
-Hawaii Docket 94-0298 (General Telephone and Electronics (GTE) Depreciation Case)
-Indiana Cause No. 39938 (Indianapolis Power and Light Company - Depreciation Case)

Participation in the above proceedings included some or all of the following:

Developing analyses, writing draft testimony, preparing data requests, analyzing issues, analyzing economic costs and principles, price elasticity and other economic issues, writing draft testimonies, preparing data requests and responses, preparing draft questions for cross-examination, drafting briefs, and developing various quantitative and economic models.

Member of the Economic Advisory Board at the University of Illinois-Springfield.

## PREVIOUS EMPLOYMENT

Sangamon State University
Graduate Assistant

- Prepared research projects on various economic topics
- Formed theoretical and statistical models
- Analyzed results of empirical models
- Formulated policy recommendations based on results.
- Worked with students

## EDUCATION

Master of Arts in Economics from Sangamon State University in Springfield, Illinois
GPA 3.97/4.0
Bachelor of Arts in Liberal Arts Economics from University of Illinois, Urbana, Illinois
Relevant Coursework:

- Mathematics and Calculus
- Statistical Analysis
- Accounting/Financial Analysis
- Economic and Statistical Modeling
- Economics in Management
- International Economics
- Environmental Economics
- Marketing

Academic Awards and Honors:
- Phi Theta Kappa Honor Fraternity
- Economics Marshall Award
- Omicron Delta Epsilon Economics Honor Society
- Who's Who at America's Colleges and Universities
- Outstanding Student in Economics Award
- Highest graduate GPA in history of Economics program

BEFORE THE

ARIZONA CORPORATION COMMISSION

| | | |
|---|---|---|
| IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN | ) ) ) | DOCKET NO. T-0151B-03-0454 |
| IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS | ) ) ) | DOCKET NO. T-00000D-00-0672 |

DIRECT TESTIMONY AND SCHEDULES

OF

WILLIAM DUNKEL

ON BEHALF OF

THE STAFF OF THE ARIZONA CORPORATION COMMISSION

NOVEMBER 2004

**NOTICE: THE CONFIDENTIAL INFORMATION HAS BEEN REDACTED FROM THIS TESTIMONY.**

## TABLE OF CONTENTS

## I. STATEMENT OF QUALIFICATIONS AND INTRODUCTION

**Q. Please state your name and address.**

A. My name is William Dunkel. My business address is 8625 Farmington Cemetery Road, Pleasant Plains, Illinois 62677.

**Q. What is your present occupation and some highlights of your background?**

A. I am a consultant providing services in telephone rate proceedings. I am the principal of William Dunkel and Associates, which was established in 1980. Since that time, I have regularly provided consulting services in telephone regulatory proceedings throughout the country. I have participated in over 140 state regulatory telephone proceedings before over one-half of the state commission in the United States, as shown on Appendix A attached hereto. I have participated in telephone regulatory proceedings for over 20 years. I have provided cost analysis, rate design, jurisdictional separations, depreciation, expert testimony and other related services to state agencies throughout the country in numerous telecommunication state proceedings. I have also provided depreciation testimony to state agencies in several electric utility or natural gas proceedings.

I am a member of the Society of Depreciation Professionals.

During the period 1975-1980, I was the Separations and Settlements expert for the Staff of the Illinois Commerce Commission.

From July, 1977 until July, 1980, I was a Staff member of the FCC-State Joint Board on Separations, concerning the "Impact of Customer Provision of Terminal Equipment on Jurisdictional Separations" in FCC Docket No. 20981 on behalf of the Illinois Commerce Commission. The FCC-State Joint Board is the national board which specifies the rules for separations in the telephone industry.

I have taken the AT&T separations school which is normally provided to the AT&T personnel.

I have taken the General Telephone separations school which is normally provided for training of the General Telephone Company personnel in separations.

I currently provide, or in the past have provided, services in telecommunications proceedings to the following clients:

The Public Utility Commission or the Staffs in the States of:

| | |
|---|---|
| Alaska | Mississippi |
| Arkansas | Missouri |
| Arizona | New Mexico |
| Delaware | U.S. Virgin Islands |
| Georgia | Utah |
| Guam | Virginia |
| Illinois | Washington |
| Maryland | Kansas |

The Office of the Public Advocate, or its equivalent, in the States of:

| | |
|---|---|
| Colorado | Missouri |
| District of Columbia | New Jersey |
| Georgia | New Mexico |
| Hawaii | Ohio |

| | |
|---|---|
| Illinois | Oklahoma |
| Indiana | Pennsylvania |
| Iowa | Utah |
| Maine | Washington |
| Florida | |

The Department of Administration in the States of:

| | |
|---|---|
| Illinois | South Dakota |
| Minnesota | Wisconsin |

**Q. On whose behalf are you testifying?**

A. I am testifying on behalf of the Staff of the Arizona Corporation Commission (ACC Staff).

**Q. Have you previously participated in any proceedings in Arizona?**

A. Yes. I have participated in several previous matters in Arizona on behalf of the ACC Staff. I conducted a Cost of Service Study on behalf of the Staff of the Arizona Corporation Commission in an undocketed matter preparing a cost study pertaining to USWC. I participated in a general rate case, Docket No. E-1051-93-183, involving USWC on behalf of the ACC Staff; I participated in a depreciation docket, Docket No. T-01051B-97-0689, involving USWC on behalf of the ACC Staff; and I participated in the general rate case, Docket No. T-01051B-99-0105, involving USWC on behalf of the ACC Staff. On behalf of the ACC Staff, I have participated in several Phases of the Wholesale cost/UNE case Docket No. T-00000A-00-0194.

**Q. What is the purpose of your testimony?**

A. I address depreciation rates, the jurisdictional separations of the cost of the interstate

DSL service, "construction charges" pertaining to BSI (BSI is an affiliate which uses some Qwest facilities when providing cable TV-like services) and the "percent condition" used in the Reproduction Cost New Less Depreciation (RCNLD) calculations. This testimony also responds to related portions of Qwest's filing.

**Q. Could you summarize your major recommendations?**

A. Yes. For the reasons presented in this testimony:

(1) I recommend the adjustment shown on Schedule WDA-15. This adjustment is incorporated into adjustments B-3 and C-6 in the Staff accounting schedules. This adjustment removes from the intrastate jurisdiction the direct costs of interstate DSL service. 100% of the DSL revenues are in the interstate jurisdiction, but Qwest is placing the majority of the DSL costs in the intrastate jurisdiction. This is a mismatch of revenues and costs, and also violates the FCC Part 36 jurisdictional separations requirements.

(2) I recommend the Adjustments shown on Schedule WDA-18. This adjustment is incorporated into adjustments B-4 and C-7 in the Staff accounting schedules. This adjustment imputes the "construction charges" that BSI should have paid to Qwest Corporation (QC) for the "video only" remote terminals (USAMs) which QC constructed for BSI's needs. Qwest originally claimed BSI had paid these construction charges, but BSI had not.

(3) The current Qwest depreciation rates in Arizona are much higher than in any other Qwest state. I propose certain modifications to the Qwest depreciation calculations.

(a) I recommend the end-of-test-year "percent reserve" values be used in the depreciation rate calculations. Qwest is using the values as of the start of the 2003 test year, but the Commission filing requirements require end-of-test-year values be used. The result of this adjustment is shown in column H of page 1 of Schedule WDA-12. This adjustment is incorporated into adjustments C-22 in the Staff accounting schedules.

(b) Qwest's depreciation calculations assume that Qwest in Arizona will retire its metallic buried cable an average of 12 years after it is placed into service. However the actual Qwest Arizona data shows Qwest keeps these investments in service an average of 58 years.

In addition, in its depreciation calculation Qwest assumed $228 million of investment would retire in the buried cable metallic account in the year 2003. The actual retirements in 2003 were $5 million. Qwest effectively pretended the "service life" of $228 million of investments ended in the year 2003 in this account, but that was not true for $223 million[1] of that investment. As a result, Qwest is not depreciating over the true "service life." Failure to depreciate over the "service life" violates the ACC and

[1] ($228 million - $5 million = $223 million).

USOA (Uniform System of Accounts) depreciation requirements. To correct these and other problems discussed in this testimony, I recommend a 23-year "projection life" for this account. My recommendation is also the mid-point of the FCC recommended life range for this account.

Based on similar analyses of the "projection lives" and "future net salvage" values of the major accounts, I recommend the depreciation rates shown in Column L of Schedule WDA-12, page 1. This adjustment is incorporated into adjustment C-23 in the Staff accounting schedules.

(4) I recommend the "percent condition" values shown on Schedule WDA-17, for reasons discussed in this testimony. The "percent condition" impacts the "fair value" rate base, but does not impact the "original cost" rate base calculations.

## II. INTERSTATE DSL SERVICE

**Q. What is DSL service?**

A. DSL (Digital Subscriber Loop) is a broadband/wideband Internet transport service provided by Qwest.[2] In order to provide DSL service Qwest must have electronic equipment, known as DSLAMs, in the central offices or in the remote terminals.[3]

[2] The Internet service itself is not provided by Qwest. The DSL service addressed in this section is provided by the Qwest Corp., which is the same corporation that also provides a regulated intrastate services. This section does not address DSL services provided by BSI or any other Qwest affiliate.
[3] This does not imply this is the only equipment needed.

For separations purposes DSL is considered a "wideband" service.[4]

The FCC has declared that DSL service used for internet access is an interstate "Special Access" service (a form of interstate "private line"service).[5] For example, paragraph 1 of that FCC Order states:

> In this Order, we conclude our investigation of a new access offering filed by GTE that GTE calls its DSL Solutions-ADSL Service ("ADSL service"). We find that this offering, which permits Internet Service providers (ISPs) to provide their end user customers with high-speed access to the Internet, is an interstate service and is properly tariffed at the federal level.

Paragraph 25 states:

> We agree that GTE's ADSL service is a **special access service**, thus warranting federal regulation under the "ten percent" rule (emphasis added).

The DSL services addressed in this section are used primarily for Internet access.[6]

The fact that DSL is an interstate Special Access service means that all of the DSL revenues are to be booked as interstate revenues, and the DSL investments are to be "direct assigned" to the interstate jurisdiction.

**Q. At the end of 2003, how much direct investment in interstate DSL service did Qwest Arizona have?**

---

[4] See Qwest response to WDA 8-15. In jurisdictional separations (47 CFR FCC Part 36) the term "wideband" is used. The term "broadband" is not used.
[5] October 30, 1998 FCC "Memorandum Opinion and Order" in CC Docket No. 98-79 (FCC 98-292), paragraphs 1,2 and 25) Interstate "Special access" is a form of interstate "private line" service. The FCC later extended this ruling to carriers other than just GTE. See the November 30, 1998 "Memorandum Opinion and Order" in CC Docket Nos. 98-168, 98-161, 98-167, and 98-103 (FCC 98-317).
[6] Qwest response to WDA 04-032 (g).

A. According to a Qwest discovery response, the Qwest-Arizona net "direct incremental DSL investment" in interstate DSL service at the end of 2003 was ** **.[7] This is shown on Schedule WDA-14

**Q. How has Qwest treated the DSL revenues and costs?**

A. Qwest has booked the DSL **revenues** to the **interstate jurisdiction**, which is proper based on the FCC's declaration of DSL as an interstate private line/special access services. However, Qwest placed the majority of the DSL **costs** in the **intrastate** jurisdiction, which is a mismatch of revenues and costs.

In request WDA 08-004 the Staff asked Qwest:

> The first page of Attachment B to the Qwest response to WDA 04-032 shows the "Direct incremental DSL investment" as of 12-31-2003....
>
> a. In the Part 36 separations of costs between jurisdictions for 2003, were each of these amounts directly assigned to the interstate jurisdiction?....
>
> Qwest answer:
>
> a. No.

The Qwest treatment of DSL revenues and major DSL costs in the test year 2003 is shown below:

[7] Qwest response to WDA-04-032.

| | DSL Revenues | Major DSL Investments[8] |
|---|---|---|
| Intrastate Jurisdiction | 0% | 64% |
| Interstate Jurisdiction | 100% | 36% |

The majority of the DSL expenses are also in the intrastate jurisdiction in the Qwest filing.[9]

Q. **How does Qwest explain the fact that they place the majority of the DSL costs in the intrastate jurisdiction?**

A. Qwest refers to FCC Order "FCC 01-162".[10] That Order froze **parts** of the separations calculations at the year 2000 level. Qwest alleges this FCC Order prevents Qwest from "directly assigning" the interstate DSL investments to the interstate jurisdiction.[11]

Q. **Does that FCC Order prevent Qwest from "directly assigning" the interstate DSL service costs to the interstate jurisdiction?**

A. No. That FCC Order does not freeze the "direct" assignments. In fact that Order specifically states states "direct assigned" costs are **not frozen**, and the Order requires

[8] See Qwest response to WDA 17-003.
[9] The allocation of the investment impacts the allocation of the expenses. In FCC Part 36 jurisdictional separations, depreciation expense and "plant specific" expenses (such as maintenance expenses) are separated based on how the investments are separated.
[10] FCC's "Report and Order" in CC Docket No. 80-286, released May 22, 2001.
[11] Qwest response to WDA 08-004(b).

"Direct assignment of private line service costs between jurisdictions shall be updated annually."[12]

From FCC Order Number FCC 01-162, Appendix C, "Final Rules"

> **§ 36.3 Freezing of jurisdictional separations category relationships and/or allocation factors**
>
> (a) Effective July 1, 2001, through June 30, 2006, all local exchange carriers subject to Part 36 rules shall apportion costs to the jurisdictions using their study area and/or exchange specific separations allocation factors calculated during the twelve month period ending December 31, 2000, for each of the categories/sub-categories as specified herein. **Direct assignment of private line service costs between jurisdictions shall be updated annually. Other direct assignment of investment, expenses, revenues or taxes between jurisdictions shall be updated annually...** (emphasis added)

In paragraph 23 of the text of that Order the FCC stated:

> 23. Similarly, we find that in order to relieve all carriers of performing traffic or relative-use studies for separations purposes, all allocation factors used to assign Part 36 categories, subcategories, or further subdivisions to the state or interstate jurisdictions shall be frozen utilizing the factors calculated for the calendar year 2000. **Categories or portions of categories that have been directly assigned in the past, however, will continue to be directly assigned to each jurisdiction. In other words, the frozen factors shall not have an effect on the direct assignment of costs for categories, or portions of categories, that are directly assigned. Since those portions of facilities that are utilized exclusively for services within the state or interstate jurisdiction are readily identifiable, we believe that the continuation of direct assignment of costs** will not be a burden on carriers, nor will it adversely impact the stability of separations results throughout the freeze.[60] (emphasis added)

and footnote 60 stated:

> 60. Examples of facilities in which a portion can be directly assigned include, Central Office Equipment- Category 2, Tandem switching equipment and Cable and Wire Facilities-Category 2, **Wideband** and exchange trunk. *See* 47 C.F.R. §§ 36.124 and 36.155. (emphasis added)

---

[12] 47 CFR §36.3(a).

Schedule WDA-16 contains the pages from the FCC Order that include the above quotations.

The FCC rules after the modification adopted in Order FCC 01-162 require that for circuit equipment:

> Direct assignment of any subcategory of Category 4.1 Exchange Circuit Equipment to the jurisdictions **shall be updated annually**. (47 CFR § 36.126, (c) (4))[13] (emphasis added)

The vast majority of the direct DSL investments shown on Schedule WDA-14 are "wideband" investments. The FCC specifically mentions "wideband" as **not** being frozen, as stated in the FCC's footnote 60 above.

**Q. Are there other FCC rules that also say that wideband investments are to be directly assigned?**

A. Yes.

FCC Rules §36.155 says:

> **Wideband and exchange trunk C&WF –Category 2-apportionment procedure.**
> (a) The cost of C&WF applicable to this category **shall be directly assigned** where feasible. If direct assignment is not feasible, cost shall be apportioned between the state and interstate jurisdictions on the basis of the relative number of minutes of use." (emphasis added)

The same rule applies to wideband exchange line circuit investment.[14]

---

[13] The above requirement applies to the "Wideband Exchange Line Circuit Equipment-Category 4.11," which is the category that contains the majority of the DSL circuit equipment direct investment. The wording that "direct assignment … to the jurisdictions shall be updated annually" is the same for all categories of circuit equipment (Categories 4.1, 4.2, and 4.2)[13] and major Cable and Wire Facilities (47 CFR §36.126, (c) (4), (e)(4) and (f)(4)).

In summary of the above, the major DSL investments are "wideband" and separations requirements say the "wideband" investments are to be directly assigned, where feasible. The FCC "Separations Freeze" Order specifically says the "direct" assignments are not frozen and must be updated annually. The FCC Order specifically mentions "wideband" as an example of what is **not** frozen.

The interstate DSL wideband costs must be directly assigned to the interstate jurisdiction. Placing the **majority** of the interstate DSL **costs** in the **intrastate** jurisdiction is a mismatch of cost and revenues (all the DSL revenues are in the interstate jurisdiction), and is in violation of the FCC Part 36 jurisdictional separations requirements.

**Q. What is Schedule WDA-15?**

A. Schedule WDA-15 shows the correction that results from direct assigning the DSL "direct" investments out of the intrastate jurisdiction. The investments used in this calculation were the direct investments provided by Qwest as shown on Schedule WDA-14.[15]

The net direct DSL investment which Qwest included in the intrastate jurisdiction in 2003 was ** **. The associated expenses were ** **, as shown on Schedule WDA-15. These are the intrastate investments and costs that were removed in

---

[14] 47 CFR §36.126(c)(1) says the wideband exchange line circuit investment is to be apportioned "in the same manner as the related exchange line cable and wire facilities as described in §36.155," which is the requirement quoted above.
[15] From Qwest response to WDA-04-032.

the adjustment shown on Schedule WDA-15. These changes are incorporated into the Staff accounting adjustments B-3 and C-6.

100% of the DSL revenues are assigned to interstate. The costs of interstate DSL service should also be "directly assigned" to the interstate jurisdiction, and therefore directly assigned out of the intrastate costs, for the reasons given above.[16]

## III. "CABLE TV LIKE" SERVICES PROVIDED BY BSI

**Q. What issue will you discuss in this section?**

A. Some Qwest Corporation (QC)[17] faculties are used by a QC affiliate, Broadband Services, Inc. (BSI), in providing TV/VDSL and other services.[18] These TV services are similar to cable TV services. In this section we will discuss the remote terminals, called USAMs. BSI generally owns the electronics used for these services, however QC generally owns the remote cabinets that house the BSI equipment and QC generally owns the cables used by BSI to provide these services. In Arizona, there are approximately 1000 QC USAM locations at which the QC cabinet contains BSI electronics, but does not

[16] This statement applies to the DSL costs shown on Schedule WDA-15. It is not implying any other DSL or private line adjustment should be made.
[17] Qwest Corporation is the company that provides the regulated services, including intrastate regulated services.
[18] VDSL (Very high bit rate digital subscriber line) is the technology that BSI uses to carry TV and other services over the QC copper cable.

also contain equipment used by QC for voice services.[19] I will call these the "video only" cabinets or "video only" USAMs.[20]

For technical reasons, the TV/VDSL signal cannot be sent over as long a copper cable as voice telephone service or DSL can.[21] Therefore to provide TV/VDSL it is reasonable to expect it would be necessary to build additional remote sites in order to bring the TV/VDSL electronics closer to the customers, to shorten the copper loop length. Qwest's response to a Staff data request:

> ***
>
> "***[22] (note ["lengths"] added to correct typographical error.)

**Q. Did BSI pay "construction charges" to QC for the locations where QC constructed cables and USAM cabinets to meet BSI's needs?**

A. In discovery over a several month period, Qwest repeatedly stated that BSI had paid "construction charges" to QC for the "video only" USAMs. When QC constructed cabinets to meet BSI's needs, "construction charges" under Section 4 of Qwest's Arizona Exchange and Network Services Price Cap Tariff should have applied. Qwest repeatedly said BSI had paid QC construction charges for such locations.

---

[19] Qwest supplemental response to WDA 17-08(c). In this section we are only addressing the USAMs installed after March 2,1999 (when BSI became responsible for the TV/VDSL services). There is additional related information in the confidential response to WDA 14-001.

[20] There are also over ***        *** other QC USAM cabinets which house both QC electronics used for voice, and BSI electronic. (Qwest response to WDA 12-003)

[21] Choice TV can be sent over a maximum of 5,200 feet of copper (Qwest response to WDA-027). DSL can be provided over 13,000 feet of copper (Qwest response to WDA 14-003S1) (Public information)

[22] Qwest supplemental response to WDA 12-009(j).

Examples of Qwest's repeated statements that BSI had paid such construction charges include:

***

.***(Qwest response to WDA 14-001(a))

Another Qwest claim that BSI paid the construction charges is:

***

*** (Qwest response to WDA 14-001(b))

In response to another request about "video only" USAMs, Qwest responded:

*** ***

(Qwest response to WDA 14-001(i))

Statement:

*** .***

Qwest response:

*** ***[23]

**Q. Had BSI paid these construction charges?**

A. No. In spite of these numerous statements by Qwest that claimed BSI paid these construction charges, the Staff was not receiving documents from Qwest that showed the amount of the construction charges BSI had allegedly paid. Finally, in a supplemental response dated November 3, 2004, Qwest acknowledged **BSI paid no construction**

---

[23] In WDA 12-009, Qwest was asked to confirm that the following are reasonable representations of statements made by Qwest personnel during the Staff on-site visit of September 9, 2004.

**charges** for the "video only" USAMS. Qwest stated pertaining to the "video only" USAMs:[24]

> WDA 17-008 (e) **BSI paid no construction charges** associated with the items included in subpart d. Qwest wishes to clarify it statement to Mr. Dunkel that "BSI paid construction charges for the construction of the USAM "video only" remote locations." A more accurate statement would be the following:
>
> The capital budget for construction of the USAM "video only" remote locations is held at the parent company, in a "VDSL program budget."
>
> The parent corporation assigns a portion of the parent company VDSL program budget to QC for the construction of USAM cabinets and for fiber placement. The parent corporation also assigns a portion of the VDSL program budget to BSI for the placement of shelves and cards. Qwest's statement that "BSI paid construction charges for the construction of the USAM 'video only' remote locations reflected the respondents' incorrect understanding that because QC was assigned budget dollars for VDSL related construction, QC received actual cash compensation from BSI for the capital expended for VDSL related construction.
>
> Confidential Attachment D shows the VDSL expenditures that were authorized and shows which come encourage expenditures related to each of the 10 sites. (emphasis added)

Qwest acknowledged Qwest's "respondents" were incorrect in their prior claims that BSI had paid these construction charges. Qwest's response to part (g) also states BSI paid no construction charges for the new cables QC installed to the "video only" USAMs.

**Q. Are the QC investments in the cabinets and cables which QC installed to serve BSI's needs in the Qwest rate base?**

[24] Part (d) of WDA 17-008 referred to "the dollar amount of the Engineer, Furnish and Install (EF&I) investment for the cabinet, site preparations, connection to the electric utility and other items owned by Qwest "core" company at that location." Of the "video only" USAMs.

A. Yes. Qwest has these investments in its regulated rate base. In response to WDA 17-008 (m) Qwest stated:

> It is a correct statement that the intrastate portion of the investments discussed in parts (b) and (f) are in the intrastate (original cost) plant in service in this case. Is also a correct statement that the investments have been depreciated and that the intrastate portion is included in the intrastate accumulated depreciation in this case. Finally, QC is being compensated for this investment through the monthly recurring charges paid to QC by BSI.

**Q. Is the above statement that "QC is being compensated for this investment through the monthly <u>recurring</u> charges paid to QC by BSI" a reasonable compensation for this investment?**

A. No. The vast majority of Remote Collocation revenues are from the non-recurring charges. ***

***

According to Qwest discovery responses, the Remote Collocation charges used by Qwest in 2003 for are as follows:[25]

| **Remote Collocation** | <u>Recurring</u> | <u>Non-Recurring</u> |
|---|---|---|
| Space per Standard Mounting Unit | $1.35 | $868.13 |
| FDC Terminations per Binder Group | $0.82 | $558.99 |
| Power | $3.64 | |

At the above rates, an un-affiliated CLEC that used a "Standard Mounting Unit" in a QC remote terminal for 5 years would pay $949.13[26] over that period. ***

[25] Attachment A to Qwest response to WDA 11-05, also Attachment A to WDA 10-15. In the current Qwest Arizona Statement of Generally Available Terms and Conditions for Interconnection (SGAT) the Remote Collocation Non-Recurring Rates are also large compared to the month rates.
[26] $868.13 NR + (60 months * $1.35) = $949.13

***

At the above rates, an un-affiliated CLEC that used an "FDC Terminations per Binder Group" in a QC remote terminal for 5 years would pay $608.19[28] over that period. ***

***

**Q. Did Qwest acknowledge that BSI ***

*****

A. Yes. In response to discovery, Qwest ***

***[30]

Request WDA 14-001 was:

(a) Please explain why Attachment A to the Qwest response to WDA 10-015 ** *** for remote collocation in the year 2003.

Qwest Response:

(a) ...***

***

---

[27] 60 months * $1.35 = $81.00

[28] $558.99 NR + (60 months * $0.82) = $608.19

[29] 60 months * $0.82 = $49.20

[30] Qwest response to WDA-10-15. and WDA 14-001.

The above Qwest response states ***

*** We later found out BSI did not pay the remote terminal construction charges either, as previously discussed. [31]

In addition, Qwest's data responses for the years 1999 through 2003 also show BSI paying *** ***[32] The reality is BSI did not pay the remote terminal construction charges, and also *** ***

**Q. How much does BSI pay QC for the average USAM remote location?**

A. BSI pays QC less than *** *** per USAM location which BSI uses.[33] In 2003 BSI paid QC a total of *** *** per month for remote collocation and the terminations at the remote collocations.[34] BSI had equipment in over *** ** QC USAMs.[35] That is less than *** *** per USAM location which BSI uses.[36]

The QC average investment in the installed "video only" USAM cabinet, site preparations, and connection to the electric utility is over *** ***.[37] Any

---

[31] This is referring to the "video only" USAMs installed after 3/2/1999.

[32] Qwest response to WDA 14-001(c) and (d) and confidential attachment A, Qwest response to WDA-10-15

[33] This include for the remote cabinet, site preparations, connection to the electric utility. This does not include BSI payment for cable, or collocation in the central office.

[34] Lines 50, 59, and 132, confidential attachment A, Qwest response to WDA-10-15.

[35] *** ***. Qwest response to WDA 12-003

[36] *** ***

[37] From Qwest Confidential Attachment B to WDA 17-8S1. This does not include cable costs. It includes furnished, engineered and installed, cabinet, site preparations, and connection to the electric utility.

reasonable calculation of the costs (cost of money, depreciation, maintenance, what QC pays for electricity, etc) would be a cost of several hundred dollars a month on a *** *** investment. At those QC owned USAMs that contain only the BSI video cards, the average of *** *** per month paid by BSI is the only QC revenue generated by that *** *** investment. [38]

**Q. What would have been done with the construction charges if BSI would have paid them?**

A. Construction charges are applied as reductions to the gross plant in service.[39] Had BSI paid the construction charges, the QC intrastate rate base would be lower than what Qwest has filed.

**Q. What is Schedule WDA-18?**

A. Schedule WDA-18 shows the adjustment to the intrastate rate base and depreciation expense as a result of adjusting for the construction charge which Qwest should have paid for the "video only" USAMs.[40] I recommend these adjustments be made for the reasons presented above. These changes are incorporated into adjustments B-4 and C-7 in the Staff accounting schedules.

**Q. Do you have any other comment on this issue?**

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[38] BSI does pay other charges, not addressed above, such as for Collocation in the central offices, or for cables, but the costs for those are not included in the investment discussed above. This discussion addresses only the Remote Collocations.

[39] Qwest response toe WDA 04-023(a)

[40] I have not included any adjustment for the USAMs which include both BSI video and QC voice cards.

A. Yes. Staff had asked for, and received a delay in our testimony filing date. It was only after our original October 19, 2004 filing date had passed that we obtained the Qwest November 3, 2004 response in which Qwest admitted that BSI had not paid the remote terminal construction charges.[41] Had we filed on our original October date, we would not have had the correct information on this issue.

Qwest has also discussed the complexity of some of my discovery. The discovery was instrumental in revealing the inaccuracy of what Qwest had been telling the Staff about the alleged BSI construction charges. The Qwest admission that BSI did not pay construction charges on the "video only" USAM cabinets was in response to part (e) of a request (WDA 17-008). The Qwest admission that BSI did not pay construction charges on the new cables which QC installed to connect to those "video only" USAMs was in response to part (g) of that request. The Qwest admission that the separated portion of the QC investments in the "video only" USAMs were in the intrastate rate base in this case was in response to part (m) of that request. It took significant discovery to obtain the facts to be placed before the Commission. As the results show, the Staff was pursuing real and significant issues.

## IV. DEPRECIATION ADJUSTMENTS

**Q. What depreciation rate adjustments will you be addressing in this testimony?**

A. I will be addressing two depreciation rate adjustments:

[41] Qwest supplemental response to Parts (e) and (g) of a request WDA 17-008.

1. Adjusting the depreciation "percent reserves" to the end-of- test year 2003 levels; and
2. Adjusting to the projection lives and net salvage values to reflect the current information pertaining to Qwest in Arizona.

**Q. Are the current Qwest depreciation rates in Arizona extremely high?**

A. Yes. The depreciation rates in Arizona are much higher than the depreciation rates in any other Qwest state. The overall Qwest intrastate depreciation rate in Arizona is 9.7 percent. Out of the 15 state jurisdictions, the **next** highest Qwest overall intrastate depreciation rate is 7.8 percent in Wyoming, and the overall depreciation rates in all other Qwest jurisdictions are lower than that.[42] Schedule WDA-1 is a comparison that was provided by Qwest and shows the Qwest depreciation rates in Arizona are much higher than in any other Qwest state. These high depreciation rates when into effect in Arizona in 2000.

**Q. As discussed above, for the past four years the depreciation rates in Arizona have been much higher than the depreciation rates in any other Qwest state. What impact do these past high rates have on the depreciation rates that should be adopted now?**

A. Under the "remaining life" depreciation that is used in Arizona, higher depreciation rates in the past results in lower depreciation rates for the future.

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[42] Data provided by Qwest. See Qwest response to (WDA 04-006). There are 15 state jurisdictions. Qwest operates in 14 states, but Idaho North and Idaho South are treated as two different regulatory service areas.

As an analogy, assume that two people owed $2,000 each, which had to be paid off in two years. Assume one person paid $1,000 toward that debt the first year. That means they have to pay $1,000 the second year. The other person paid $1,500 towards that debt the first year. That means they only have to pay $500 towards that debt the second year.

The customers in Arizona are similar to the second person in this analogy: for the past several years Arizona customers have been supporting depreciation rates which are much higher than the depreciation rates in any other Qwest state. As a result, we should expect that the properly calculated new Arizona depreciation rates would be lower than average.[43]

**Q. Has Qwest proposed a change in depreciation rates in this proceeding?**

A. Yes. Qwest proposes to revise the depreciation rates to incorporate the depreciation "percent reserve" and investment amounts[44] as of the **start** of the 2003 test year (amounts as of 1/1/2003).[45] This revision reduced the intrastate depreciation expense by $109.7 million per year, according to Qwest. Qwest calculated this amount based on the "percent reserve" and investments at the **start** of the test year (amounts as of 1/1/2003).[46]

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[43] The depreciation "accruals" go into the depreciation reserve ("Accumulated Depreciation"). When actual retirements occur, funds are removed form the depreciation reserve. Since the "accruals" have been higher than the retirements, the amount in the depreciation reserve has grown rapidly. In a "remaining life" depreciation calculation, the depreciation reserve is used in the calculation of the revised depreciation rates. A higher depreciation reserve results in lower depreciation rates.

[44] A table of the surviving investments by year installed, (called the "generation arrangement") is used in the depreciation "remaining life" calculation.

[45] Exhibits KDW-2 of the direct testimony of K. Dennis Wu, Qwest. The "generation arrangements" as of 1/1/2003 were also used in this calculation.

[46] Based on the generation arrangement and percent reserves as of December 31, 2002 (Exhibit KDW-2) also called 1/1/03 (Exhibit KDW-1).

**Q. Is there a problem with Qwest's proposed use of the percent reserve and investments as of the start of the 2003 test year?**

A. Yes. Qwest adjusted these "percent reserve" figures to the **start** of the test year level. However, the Commission rules require that the **end** of the test year figures be used.

For example, R14-2-103 A.(3)(h) defines "original cost" as determined "at the end of the test year".

There are also numerous other requirements in R14-2-103 to use the "end of the test year" figures.[47]

**Q. Has the Qwest percent reserve in Arizona grown rapidly since the higher depreciation rates went into effect?**

A. Yes. Shown below are the overall Qwest Arizona percent reserve levels at the end-of-year:

[47] For example, R14-2-103 A.(3)(n) and R14-2-103 A.(3)(p).

| | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|---|---|---|
| Percent Reserve:[48] | 45% | 47% | 49% | 50% | 49% | 50% | 56% | 62% |
| Change over Prior Year: | | 2% | 2% | 1% | -1% | 1% | 6% | 6% |

The "accruals" that result from the depreciation rates go into the depreciation reserve. When plant is retired, money is removed from the depreciation reserve. When the accruals from the depreciation rates are much higher than the actual retirements, that in-balance results in a rapid growth of the depreciation reserve.

## A. UPDATE DEPRECIATION RESERVE TO END OF TEST YEAR

**Q. What is the first depreciation rate correction that Staff proposes?**

A. The first Staff depreciation rate correction is to calculate the depreciation rates using the depreciation reserve percents and investments that existed at the **end** of the test year, instead of the depreciation reserve percents and investments that existed at the **start** of the test year. The percent reserves are significantly higher at the end of the test year then they were are the start of the test year. At the start of the 2003 test year the overall percent reserve was 55.8%.[49] At the end of the test year the overall percent reserve was 62.1%.[50] Higher depreciation reserves result in lower depreciation rates.

[48] Intrastate Arizona Qwest percent reserve (depreciation reserve as a percent of Plant in Service). End of year figures. Source Qwest response to WDA 02-026 (Public information)
[49] Wu Exhibit KDW-1, "Intrastate Statement C".
[50] Page 4 of Schedule WDA-2, attached (this is a page from Qwest response to Staff request WDA 02-005). Note, the specific percent reserve for each account is used in the depreciation rate calculation.

**Q. Why does the "percent reserve" impact the depreciation rates?**

A. Percent reserve is one of the three values that is used to calculate the depreciation rate. The formula used to calculate the depreciation rates is as follows:

Depreciation rate = (100%-(percent reserve)-(future net salvage))/ (avg. remaining life)

The values specific to the specific company and specific account are used in the calculation.

**Q. What is the impact of using the percent reserve figures from the end of the test year, instead of the percent reserve as of the start of the test year?**

A. The result of this correction is to reduce the annual intrastate depreciation accruals by approximately[51] $163 million below the current rates.[52]

**Q. What is a source of these revised figures that utilize the end-of-test-year depreciation reserves and investments?**

A. These revised calculations were provided by Qwest during the discovery process. Page 3 of Schedule WDA-2 shows the Qwest calculation of $163 million reduction in annual

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[51] All depreciation dollar impacts in this testimony are approximate. I recommend depreciation rates. Other Staff witnesses apply those depreciation rates to the investments. Adjustments may have been made to their investment amounts, so the impact of the depreciation rates may be somewhat different than the approximate impacts discussed herein.

[52] This figure was provided by Qwest in response to WDA 01-010 and 02-005, pages from these responses are attached as Schedule WDA-2.

intrastate depreciation accruals below current rates when the end-of-test-year percent reserves and end-of-test-year investment levels are utilized.[53]

I performed a similar calculation with similar results. Details of this adjustment are shown on Schedule WDA-12, page 2, column T.

Using the end-of–test-year percent reserve, the annual depreciation expense is $163 million lower than under the current rates. However, Qwest had already proposed some adjustment from the current rates, as previously discussed. The result of this Staff correction is to reduce the annual intrastate depreciation expense by $53 million more than the Qwest adjustment, as is shown on line (1) of Schedule WDA-3.

**Q. What do you recommend on this first depreciation rate issue?**

A. I recommend that the percent reserves as of the end-of-the-test-year be utilized in the depreciation rate calculations. These are the 12/31/2003 values. The use of the end-of-the-test-year figures is consistent with the Commission's standard filing requirements.[54] This correction is incorporated into adjustment C-22 in the Staff accounting schedules.

## B. UPDATE DEPRECIATION "LIVES" AND "NET SALVAGE"

**Q. What is the second depreciation adjustment that Staff proposes?**

[53] This figure was provided in response to request WDA 02-005. Request WDA 02-005 was a follow-up to request WDA 01-010. The last page of Schedule WDA-2 is the WDA 01-010 request, to clarify what was issue being addressed in these calculations.

[54] For example, R14-2-103 A.(3)(h) defines "original cost" as determined "at the end of the test year". There are also numerous other requirements in R14-2-103 to use the "end of the test year" figures. (For example, R14-2-103 A.(3)(n) and R14-2-103 A.(3)(p)).

A. The second depreciation adjustment that Staff proposes is to revise the depreciation rates based upon more current Qwest Arizona "life"[55] and "future net salvage" information. "Average remaining life" and "future net salvage" are two factors that are used in the calculation of the depreciation rates (along with the previously discussed "percent reserve").

As stated on page 8 of the Direct Testimony of K. Dennis Wu, the current Arizona depreciation rates were based on information as of 1/1/1997. In this proceeding Qwest does not propose to update the "lives" or "future net salvages" used in the depreciation rate calculations. We now have seven additional years of more recent information. Staff included this more recent information in determining revised "lives" and "future net salvages" for Qwest in Arizona. The differences in "future net salvage" values are relatively insignificant except in one account,[56] so this adjustment is primarily related to differences in "lives."

**Q. Why are the current Arizona depreciation rates much higher than in any other Qwest jurisdiction?**

A. The major reason is that in the last depreciation case in Arizona, Docket T-01051B-97-0689, Qwest advocated adopting short projection lives for most major accounts. Qwest presented a witness and a study that alleged the there would soon be a massive, accelerated modernization and retirements. As a result, they projected massive retirement of the existing investments in the near future. According to that Qwest presentation, the

[55] The "projection live" is a key factor used in the calculation of the "average remaining life."
[56] The "future net salvage" issue is significant in the "poles" account.

"projection lives" used in the depreciation calculation had to be shortened drastically because of this upcoming massive modernization.[57] Qwest also alleged the Commission should base Qwest's depreciation rates on information pertaining to IXCs and CLECs.

In that case, the Commission generally adopted drastically shortened projection lives for many major accounts.

The short "lives" resulted in much higher depreciation rates and a much higher depreciation expense. These higher depreciation rates went into effect in May 2000.[58]

**Q. Did the forecasted massive accelerated modernization actually occur?**

A. No. In fact Qwest's construction expenditures in Arizona actually have **declined greatly** after the higher depreciation rates went into effect in the year 2000.

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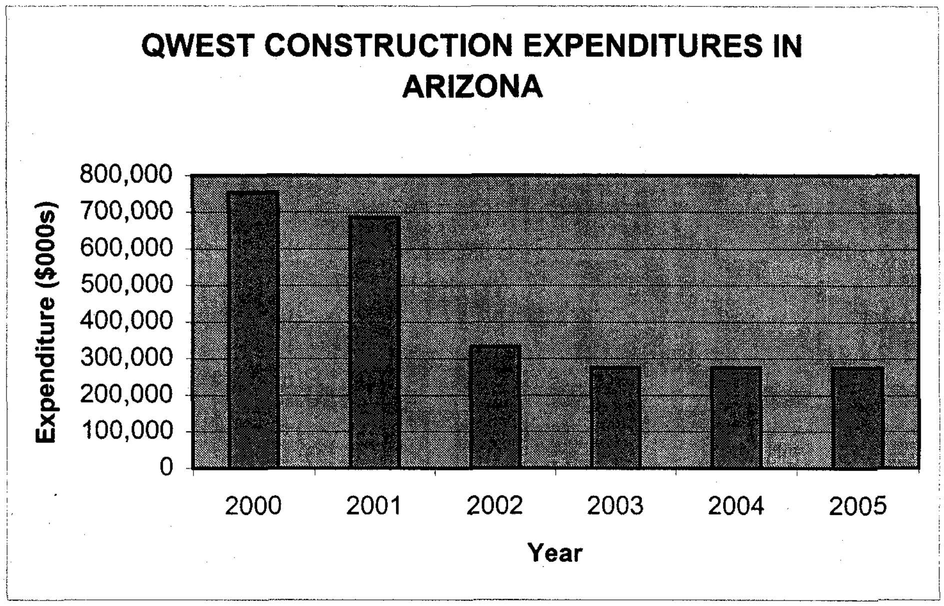
[57] Lawrence K. Vanston, Qwest witness in Docket No. T-01051B-97-0689, who also authored "Transforming the Local Exchange Network" used by Qwest in that case.

[58] Qwest response to WDA 02-003




This graph is also attached as Schedule WDA-4.

The Qwest construction expenditures in Arizona are now one-third what they were in the year 2000. In addition, Qwest now forecasts that its construction expenditures in Arizona will continue to be one-third of what they were in 2000.[59]

It is now very clear that Qwest did not undertake the massive accelerated modernization that was forecast. For the last four years the ratepayers in Arizona have been supporting high depreciation rates on the basis of a forecast of near term massive accelerated modernization and retirements, but the massive accelerated modernization and retirements never actually happened.

**Q. What is Qwest effectively asking the Commission to do in this proceeding?**

[59]Qwest forecasts construction in Arizona in 2005 as the same as it was for 2003. (Schedule F-3 of the Qwest standard filing requirements in this case.)

A. In this filing Qwest is again effectively asking the Commission to calculate depreciation rates based on the assumption of massive retirements occurring in the near future.

**Q. What is the "projection life"?**

A. The "projection life" is used in the calculation of the "remaining life". A "projection life" is the average life expectancy of new assets. This is the average number of years between the time a new investment goes into service, and the time it is expected to retire from service. The "remaining life" is the average of the future life expectancies of all items in a particular plant account.

**Q. What "projection life" did Qwest use for the largest depreciable account, which is the Buried Cable Metallic account?**

A. Qwest used a 12-year "projection life," which results in a 5.5 year average "remaining life."

**Q. How does a 12-year "projection life" compare to the actual recent experience of Qwest in Arizona in this account?**

A. For this account, graphed below is a comparison of the Qwest Arizona "observed" survivor curve to the survivor curve for the 12-year "projection life"[60] that Qwest is using:

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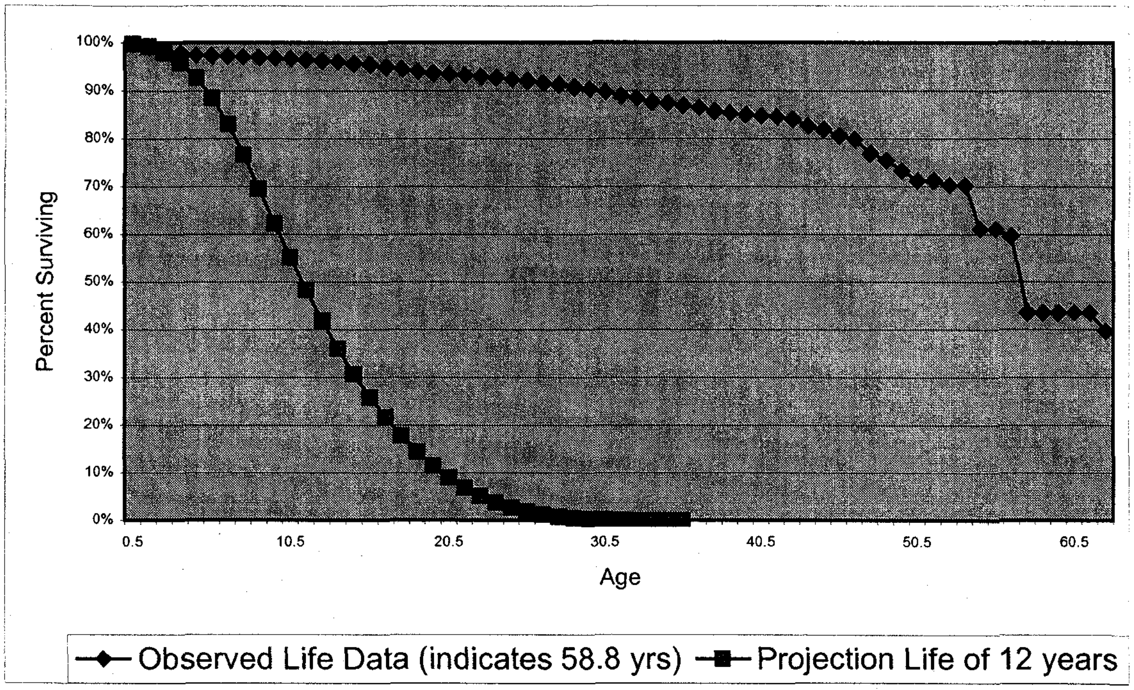
[60] The "dispersion" (Iowa curve) used is also the same as Qwest is using. The 12 year projection life is the same as Qwest is using.

**Graph of Recent Observed Life Data and Qwest Projection Life**
**Account 2423 - Buried Cable - Metallic**




As this shows, the 12-year projection life does not match the actual recent experience and data of Qwest in Arizona. This graph is also part of Schedule WDA-19.

**Q. What is the actual observed average service life in the buried cable metallic account of Qwest in Arizona?**

A. Based on the most recent data,[61] the observed average service life in the buried cable-metallic account of Qwest in Arizona is 58.8 years. This observed life figure was

[61] The data in the chart above was from activities in this account for Qwest in Arizona in the years 2001, 2002, and 2003.

calculated by Qwest and provided to the Staff.[62] A copy of the Qwest response that provided the 58.8-year observed life is attached as Schedule WDA-10.[63]

**Q. Is Staff proposing a 58.8-year projection life for this account?**

A. No. The FCC has established "ranges" in which the projection lives for various accounts are expected to fall. The FCC uses the ranges for determining the cost to be included in the High Cost Fund (HCF), for purposes of setting unbundled network element (UNE) and interconnection rates, and to determine the reasonableness of the price of new services.[64] To be conservative, Staff is not recommending a revised projection life for any account that is longer than the midpoint of the FCC range for that account.[65] This is a reasonable, but conservative, step at this time. For buried cable metallic the FCC range for projection lives is 20 to 26 years. As a result, the Staff recommendation is a 23-year projection life, although the actual current data shows that Qwest in Arizona keeps their investment in this account in service much longer than a 23 year average. Since the investment in this account is already 12.4 years old on average, the observed life indication is over 58 years, and Qwest has no plans for massive retirements in this account, the expectation that these investments will retire an average of 23 years after they when into service is very conservative.

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[62] Attachment A to Qwest's response to WDA-02-06S1. As is the accepted practice, the most recent "band" was used. This figure is based on the retirements and other data for the years 2001, 2002, and 2003. None of the data in these years existed at the time of the prior Qwest depreciation case in Arizona.
[63] This calculation used the accepted method of analyzing data to determine the observed average life. This accepted method looks at the percent of the investment that retires each year of life, in the actual data of Qwest in Arizona.
[64] Paragraphs 34 and 39, FCC Order 99-397 CC Docket No. 98-137, released December 30, 1999.
[65] For some accounts the existing projection life was supported by the data and we have not changed those existing approved projection lives. Some of those existing projection lives were outside the FCC range. But any change in projection lives Staff proposes are all with the FCC range.

As stated above, the observed life in this account is well in excess of 23 years based on the most recent information.[66]

Staff recommends a 23-year projection life for the buried cable-metallic account, which results in a 12.0-year average remaining life, as shown on schedule WDA-11.

**Q. Does this recommendation assume the future will be identical to the past?**

A. No. This proposal does not assume that the future will be identical to the past. Using 23 years instead of the "observed" 58 years average life means Staff has included a generous allowance for the possibility that the investments may live a shorter average life in the future than they have in the past.

**Q. Is Qwest planning any widespread retirement of buried metallic cables?**

A. No. There are three different Qwest sources that indicated that Qwest is not planning a massive retirement of the existing buried cable metallic investments:

(1) A recent Wall Street Journal Article stated:

> Qwest Communications International Inc., the local phone company in 14 Western states, has decided to roll fiber out only to new housing developments, and its chief executive officer, Richard C. Notebaert, has dismissed a blanket rollout of the technology as not economical.[67]

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[66] Based on Qwest's activity in the years 2001, 2002, and 2003. Qwest had a larger retirement in 2000 than in other years, but the overall average of the data since the prior Qwest depreciation case is consistent with the Staff's recommendation.

[67] November 8, 2004 Wall Street Journal article entitled "Showdown of the Giants", by Jesse Drucker, Dennis K. Berman and Peter Grant.

(2) In Schedule F-3 of R-14-2-103 standard filing requirements, Qwest's forecast for its construction budget through the year 2005 is the same construction level it had in 2003, so no massive accelerated replacements are forecast by Qwest.[68]

(3) In request WDA 04-11 we asked Qwest:

> WDA 04-011 (a.) Please provide a copy of any QWEST plans for the widespread retirement of Buried Cable-Metallic in the distribution portion of the network.

In response they provided no copy of any such plans. Qwest stated:

> a. Any Qwest retirement plans are provided and disclosed at http://www.qwest.com/disclosures/.

A review of that website contained no Qwest plans for the widespread retirement of buried metallic cable.

**Q. If Qwest does start installing a different technology "only to new housing developments" does that mean that existing buried cable in the existing housing developments will be retired quickly?**

A. No. That would indicate the existing cable would continue to be used in the existing housing developments. Of course, everything retires someday, the Staff proposal for the buried cable metallic account includes a projection life of 23 years (which results in an average remaining life of 12 years). The projection life of 12 years (which results in an average remaining life of 5.5 years), which the Company proposes, is not realistic and is inconsistent with Qwest's own plans. Qwest's calculations effectively assume that all of

[68] Also, see the Confidential file provided by Qwest titled "Inputs-1203.xls" shows ** 
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the metallic buried cable that Qwest had in service on 1-1-2003 would retire an average of 5.5 years after 1-1-2003, which would be in the middle of the year 2008, on average. To retire all the existing buried metallic cable in an average of 5.5 years would require a massive project by Qwest, which Qwest is not planning to undertake. As previously stated, Qwest has "dismissed a blanket rollout of the technology as not economical" and is limiting any change "only to new house developments."

## C. THE QWEST DEPRECIATION CALCULATIONS VIOLATE THE ACC AND USOA UTILITY DEPRECIATION REQUIREMENTS.

**Q. What is a related problem with the Qwest depreciation calculations?**

A. The Qwest proposal violates the ACC and Uniform System of Accounts (USOA) utility depreciation requirements. The ACC and USOA both require that investments be depreciated over their "service life." The "service life" ends when the investments retire from service. However for purposes of calculating the depreciation rates, Qwest ends the investments alleged "life" before they actually retire, so Qwest is not depreciating the investments over their "service life."

**Q. What is the Arizona Administrative Code definition of depreciation for regulated utility purposes?**

A. The Arizona Administrative Code, Section R-14-2-102(A)(3) states:

> 'Depreciation' means an accounting process that will permit the recovery of the original cost of an asset less its net salvage over the <u>service life</u>. (emphasis added)

Section R14-2-102(B)(3) requires:

> The cost of depreciable plant adjusted for net salvage shall be distributed in a rational and systematic manner over the estimated service life of such plant. (emphasis added)

Section R14-2-102(A)(9) states:

> 'Service life' means the period between the date an asset is first devoted to public service and the date of its retirement from service. (emphasis added)

**Q. What is the USOA definition of depreciation for regulated telephone utility?**

A. The FCC and ACC both use the Uniform System of Accounts (USOA) for Telecommunications Companies (FCC Part 32, 47 CFR, Ch. 1). The USOA requires that depreciation be over the "service life."

Under "Depreciation Accounting", the USOA requires that:

> ...the loss in service value of the property ...be... distributed under the straight-line method during the service life of the property." (emphasis added, §32.2000(g)(1))

That service life ends when the investment is "retired from service". (USOA Part 32.2000(d))

**Q. How much investment retired in the Qwest Arizona buried cable metallic account in the year 2003?**

A. As shown on Schedule WDA-5, Qwest retired $5.1 million in this account in the year 2003. This means the "service life" of $5.1 million of investment ended in the year 2003 in this account.[69]

**Q. For purposes of calculating the average "remaining life" used in their depreciation calculation for this account, what retirements in the year 2003 did Qwest assume?**

A. For purposes of calculating their depreciation rate, Qwest assumed $228 million of "retirements" for Qwest in Arizona in this account (the buried cable metallic account) in the year 2003. Qwest effectively pretended the "service life" of $228 million of investment ended in the year 2003 in this account, although that was not true. The "service life" of $223 million out of that $228 million continued past 2003. So Qwest is not using the "service life" of that $223 million of investment.[70]

Schedule WDA-6 summarizes the year 2003 "retirements" that are assumed in the Qwest depreciation calculation. The Qwest "remaining life" depreciation calculation assumes retirements in 2003 that are 44 times the actual 2003 retirements in this account.[71] Qwest's depreciation calculation has no relationship to reality and is not using the "service life." The service life ends on the "date of retirement from service," but Qwest is removing massive amounts of investment from the depreciation calculations <u>before</u> those investments "retire" (ending their "average service life"). The resulting Qwest

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[69] As shown on Schedule WDA-5, in most recent years the retirements in this account have been in the range of $5 to $7 million dollars per year. The highest retirement year was $46 million, and the lowest $0.4 million. As previously discussed, Qwest's construction plans as far ahead as they provided information (through 2005) are similar to what they were in 2003, so Qwest has no plans for massive retirements in the foreseeable future. The average retirement in this account was $9 million per year over the last ten years.
[70] The problem is not limited to the year 2003 in the Qwest calculation.
[71] The retirements in other years in the near future are also excessive, in the Qwest depreciation calculation.

"remaining life" figures, and resulting Qwest depreciation rates, also have no relationship to reality.

For many other major accounts the year 2003 "retirement" amounts used in the Qwest depreciation calculations were also many times the actual 2003 retirement amounts, which effectively means Qwest is not depreciating over the "service life", as discussed above.

The Qwest proposed depreciation rate for the buried cable metallic account is inconsistent with the USOA and ACC requirements that the depreciation be over the "service life."

For depreciation purposes, Qwest is effectively pretending that Qwest is currently involved in massive, accelerated retirements and modernization in Arizona, but it really is not. Customer should not pay real money for imaginary retirements.

**Q. What is Schedule WDA-7?**

A. This is a response from Qwest that confirms our understanding of the year 2003 retirements they had included in their "remaining life" calculation was correct.

**Q. How does the Qwest massive overestimate of the 2003 retirements impact the depreciation rates Qwest is recommending?**

A. These overstated retirements were used in the calculation of the Qwest average "remaining life." By pretending this $288 million of investments would retire in 2003, Qwest assigned it a 0.5-year "remaining life."[72] This was included in the 5.5 year average remaining life which Mr. Wu proposes as shown on his Exhibit KDW-1, Statement A.[73] Of course, the vast majority of that $288 million of investments did not retire in 2003, which means their actual remaining life was longer than Qwest pretended. Since only $5.1 million actually retired in 2003, the Qwest average remaining life cannot be reasonably accepted.

Similar overestimates of retirements exist in other near future years in this Qwest remaining life calculation as well.

**Q. How was the improper 5.5-year remaining life used by Qwest to calculate the depreciation rate that Qwest proposes for this account?**

A. Qwest proposes an 8.1% depreciation rate for this account.[74] That depreciation rate was calculated as shown below:

Depreciation rate = (100%-(percent reserve)-(future net salvage))/ (avg. remaining life)

=(100%-62.6%-(-7%))/5.5 years remaining life

= 8.1%

[72] In depreciation, investments are assumed to retire in the middle of the year.
[73] This 5.5 years is the weighted average of the remaining lives shown on each line of pages 1 and 2 of Schedule WDA-8. Page 2 shows the 5.5 (shown as 5.52927) Pages 3 and 4 show how he calculated those remaining lives. Column C shows the amount he expected to retire in the coming year. For example, at 19.5 years age, he expected $2,508 to retire in the coming year out of each $11,444 surviving investment, or 21.91% of the 19.5 year old plant expected to retire in the coming one year (2003).
[74] Qwest Exhibit KDW-1, Statement A, Column H. Note: This Qwest calculation improperly uses the "start of year" percent reserve, as discussed elsewhere in this testimony.

The improper 5.5 year average remaining life was used to calculate the improper depreciation rate that Qwest proposes.

**Q. Please summarize the above point.**

A. Contrary to the ACC and USOA requirements, Qwest is not depreciating the investments over the "service life." The "service life" ends when the investments are retired from service. By using figures which do not reflect true retirements or true retirement expectations, Qwest is calculating depreciation over a period which ends prior to the time the investments actually retire from service. Qwest is not depreciating over the "service life." This violates the ACC and USOA requirements.

## D. PROJECTION LIVES OF OTHER MAJOR ACCOUNTS

**Q. You previously discussed the projection life in the Buried Cable Metallic account. In what accounts did you review the projection lives and future "net salvages"?**

A. I reviewed the projection lives and future net salvage values of all accounts in the major investment categories, which are Cable and Wire Facilities (24XX accounts) and Central Office Equipment (22XX accounts). My analysis procedure for these other accounts was similar to the analysis I previously described for the Buried Cable Metallic account.

The accounts in which the Staff recommends a different projection life can be seen in columns D and E of Schedule WDA-12, page 5. The FCC ranges are shown in columns A and B on that same page. The recent observed life is shown in column C.

In all accounts in which Staff is proposing a change in the existing projection life, the new value Staff is proposing is does not exceed the mid-point of the FCC range for that account.[75]

I did not review the lives or net salvage parameters of the Support Assets Accounts (21XX accounts, such as Furniture) or the Other Terminal Equipment account (2362). These account categories are relatively minor compared to the investments in Cable and Wire Facilities and Central Office Equipment. I did not address the minor investment categories in order to focus resources on the significant categories.[76]

**Q. What other accounts will you specifically discuss in this testimony?**

A. I will discuss the most significant accounts. As shown in Column W on page 2 of Schedule WDA-12, the largest adjustments were in the Digital Switching Equipment, Circuit Digital, and Buried Cable-Metallic accounts. Above I have discussed the Buried Cable-Metallic account, account 2423. I will discuss Digital Switching Equipment and Circuit Digital Equipment below.

**Q. What is some of the key information pertaining to the projection life in the Digital Switching Equipment account, account number 2212?**

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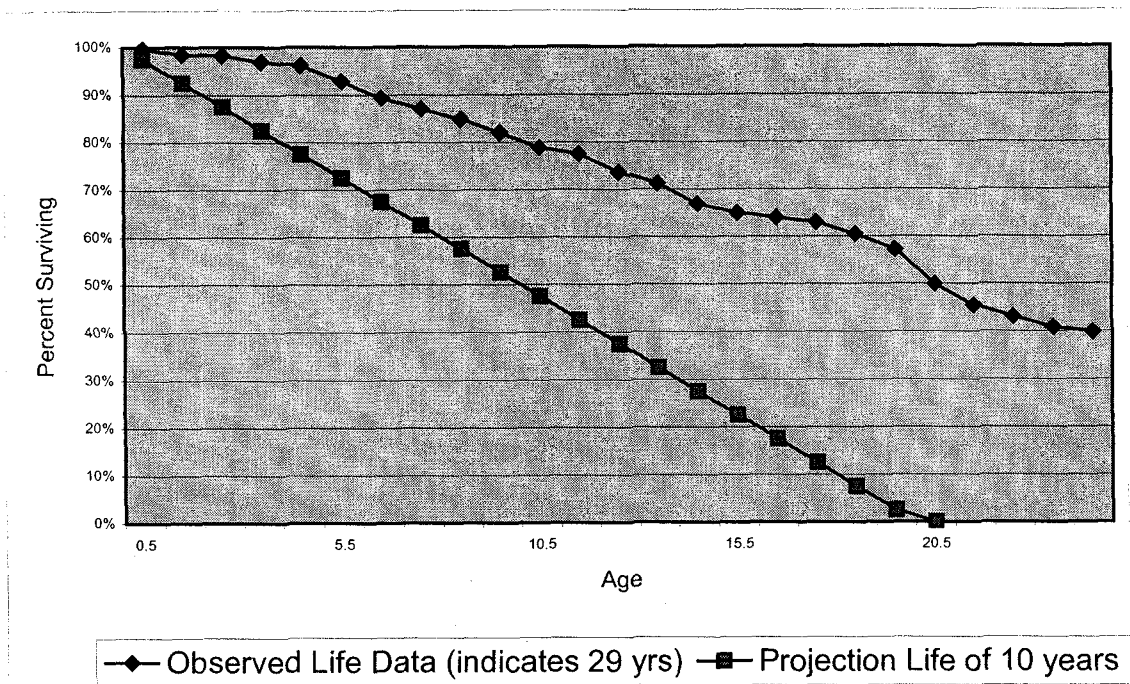
[75] If the current projection life is outside the FCC range, and Staff has not recommended a change in the projection life in that account, the projection life could continue to be outside of the FCC range.

[76] To simplify the case, I also did not address any possible change to the curve shapes (retirement dispersions).

A. Some relevant information is shown on page 5 of Schedule WDA-12. The observed life is 29 years, as calculated by Qwest based on Qwest activities in the most recent years. The FCC projection life range for this account is 12 to 18 years.

For this account, graphed below is a comparison of the Qwest Arizona "observed" percent survivor curve to the survivor curve for the 10-year "projection life"[77] that Qwest is using:

**Graph of Recent Observed Life Data and Qwest Projection Life**
**Account 2212 - Digital Switching Equipment**




As this shows, the 10-year projection life does not match the actual experience and data of Qwest in Arizona. This graph is also part of Schedule WDA-19.

[77] The "dispersion" (Iowa curve) used is also the same as Qwest is using. The 10- year projection life is the same as Qwest is using.

Staff recommends a 15-year projection life, this is mid-range in the FCC range for this account.[78] The average age of the investment in this account is 7.2 years. In the years 2000 through 2003, Qwest retired an average of 2.2% of the investment per year in this account. Since the Qwest construction budget forecast through the year 2005 is the same level of construction Qwest had in 2003, the evidence does not support the belief that this investment will retire an average of 10 years after it was placed in service.

Staff recommends a 15-year projection life for the Digital Switching Equipment account.

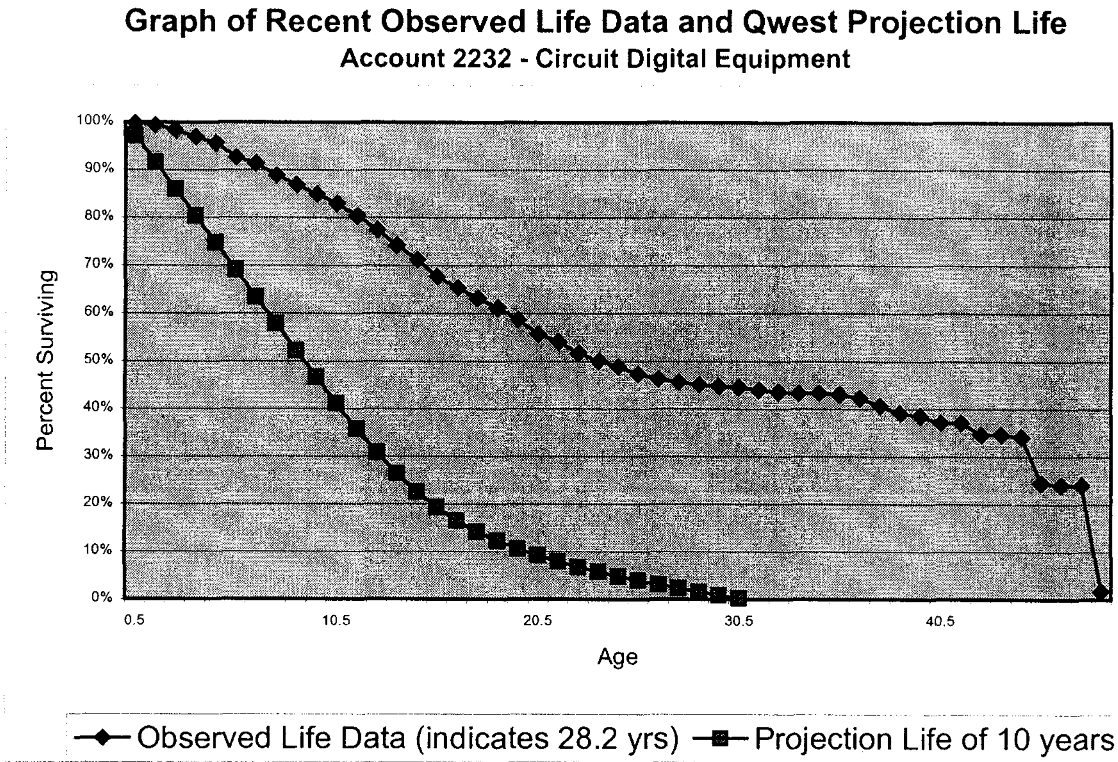
**Q. What is some of the key information pertaining to the projection life in the Circuit Digital account, account 2232?**

A. Some relevant information is shown on page 5 of Schedule WDA-12. The observed life is 28.2 years, as calculated by Qwest based on Qwest activities in the most recent years. The FCC projection life range for this account is 11 to 13 years.

For this account, graphed below is a comparison of the Qwest Arizona "observed" percent survivor curve to the survivor curve for the 10-year "projection life"[79] that Qwest is using:

[78] The observed life data from prior year bands are also above 15 years.

[79] Exhibit KDW-1, "Parameter Report". The "dispersion" (Iowa curve) used is also the same as Qwest is using.




As this shows, the 10-year projection life does not match the actual recent experience and data of Qwest in Arizona. This graph is also part of Schedule WDA-19.

Staff recommends a 12-year projection life. This is the mid-range of the FCC range for this account. Qwest has not provided any plans that indicate any future drastic change in the investment in this account, as compared to recent activities. The average age of the investment in this account is 7.3 years. The currently approved projection life is 10 years. In the years 2000 through 2003, Qwest retired an average of 1.9 % of the investment per year in this account. As previously discussed, Qwest does not plan accelerated construction in Arizona in the foreseeable future (Qwest standard filing requirement Schedule F-3).

Staff recommends a 12-year projection life for the Circuit Digital account.

## E. USE OF CLEC, IXCS OR CATV "FINANCIAL REPORTING" LIVES

**Q. In this case Qwest is serving discovery on CLECs/IXCs asking for their "regulated and financial reporting depreciation" information.[80] Is this information relevant?**

A. No, for several reasons as will be discussed below.

**Q. What is the first reason any such response from the CLECs/IXCs would not be relevant?**

A. The Qwest depreciation rates to be determined in this case are for **utility regulatory** purposes. The depreciation rates in this case must be determined following the requirement that apply to **utility regulatory** depreciation. We previously discussed some of the ACC and USOA requirements.

There are many different types of "depreciation," just as there are many different types of doctors. A person with a PhD. in economics is a "doctor" but they are not qualified to operate on you.

[80] Questions 3 through 10, Qwest's First Set of Data Requests To AT&T of the Mountain States, Inc. in this docket, dated July 21, 2004.

**Q. Do the CLECs/IXCs calculate depreciation rates using the USOA/ACC requirements that apply to utility regulatory depreciation?**

A. No. In the oral argument pertaining to Qwest's Motion to Compel, the AT&T attorney stated that AT&T does not have regulated depreciation rates, and has not calculated depreciation on a utility regulated basis for many years. However, Qwest continued to seek information from AT&T, knowing that any response on "depreciation" will **not** be "depreciation" calculated consistent with the USOA/ACC utility regulatory depreciation requirements.

In a prior proceeding various IXCs/CLECS had already stated that they do not have any depreciation rates calculated on the utility regulatory standards.

In response to the ALJ's Request in Docket No.T-01051B-97-0689, both AT&T and E-spire Communications stated that they had no utility commission-regulated depreciation rates or projected lives:

> Finally, as stated in its January 14, 2000 filing in this docket, AT&T does not have any depreciation rates or projected lives set by state regulatory agencies for purposes of rate of return regulation.[81]

In addition, Cox Arizona Telecom, L.L.C. stated:

> Cox Arizona Telecom, L.L.C. states that: (i) it does not use 'rate of return' depreciation lives or rates…[82]

[81] Page 2, AT&T's Supplemental Comments on Depreciation Rate Schedules filed on February 2, 2000, Docket No. T-01051B-97-0689.

[82] Cox Arizona Telecom, L.L.C.'s Filing on Depreciation Lives and Rates Pursuant to January 7, 2000 Procedural Order. Docket No. T-01051B-97-0689.

In the current case, the Qwest requests to these companies asked for "regulated and financial reporting depreciation" information, but Qwest knew these CLECs/IXCs do not have **utility regulatory** depreciation rates calculated in accordance with the USOA/ACC depreciation requirements. Since these companies do not have **utility regulatory** depreciation rates, the only "depreciation" information they could provide is whatever they have, which might be "depreciation" based on "financial" reporting or "tax" reporting requirements, or other that is not based on the USOA/ACC depreciation requirements. "Depreciation" that is not calculated using the standards which are relevant in this case, is not relevant. Qwest did not limit its request to asking these CLEC/IXCs to provide depreciation information which was based on the USOA/ACC **utility regulatory** depreciation requirements.

**Q. Are the "depreciation" rates as determined for "financial reporting" purposes based on the same requirements as depreciation rates for utility regulatory purposes?**

A. No. The ACC rules and the USOA contain specific requirements, such as the depreciation must be over the "service life," and the "service life" of an investment is the period which ends on the "date of its retirement from service." The "financial reporting" lives are not calculated based on the USOA/ACC requirements.

The FCC addressed this in its Order on depreciation dated December 30, 1999. The "GAAP" and "SEC" requirements the FCC is discussing below are the requirements which apply to "financial reporting depreciation."

> Additionally, the Commission has previously rejected the incumbent LECs' argument, stating that "GAAP is guided by the conservatism principle which holds, for example, that, when alternative expense amounts are acceptable, the alternative having the least favorable effect on net income should be used." The Commission concluded that, although conservatism is effective in protecting the interests of investors, it may not always serve the interests of ratepayers, and did not offer adequate protection for ratepayers in the case of depreciation accounting. (Citations omitted)
>
> We believe that giving incumbent LECs the right to select, for regulatory purposes, any depreciation rate allowed by GAAP is inappropriate as long as incumbent LECs reserve the right to make claims for regulatory relief based on the increased depreciation that would result from granting them that flexibility. (Citations omitted)
>
> These other safeguards, such as SEC requirements, are not adequate substitutes for depreciation represcription because they are not designed to protect ratepayers, but are designed to protect investor interests. (Citations omitted)[83]

The Qwest requests to the CLECs/IXCs specifically ask for "financial reporting depreciation" information. "Financial reporting depreciation" is determine using different requirements than the requirements which apply to **utility regulatory** depreciation, as the FCC stated in the quotation above. Therefore any "financial reporting depreciation" information is not based on the proper standard for this proceeding.

**Q. Does the FCC allow the use of "financial reporting" lives in depreciation which is used to set customer rates?**

A. No. The FCC does not allow the use of "financial reporting" rates or lives for purposes that affects ratepayers. As a result of the FCC Order quoted above, the FCC now allows companies which are <u>not</u> rate of return regulated to file "financial reporting" depreciation rates with the FCC, but the FCC does not allow them to use those "financial reporting"

[83] FCC 99-397, paragraphs 48 and 49, December 30, 1999.

depreciation rates in calculations which would impact customer rates. Instead, the FCC stated it would continue to maintain and use the FCC depreciation "ranges" (which are based upon utility depreciations requirements) for depreciation that effects rates. Specifically:

(1) The FCC will not allow the companies to adjust their "price caps" as a result of depreciation rates which result from those "financial" lives.

(2) The FCC uses the "ranges", not the "financial" lives, for determining the cost to be included in the High Cost Fund (HCF),

(3) The FCC uses the "ranges", not the "financial" lives, for purposes of evaluating unbundled network element (UNE) and interconnection rates,

(4) The FCC uses the "ranges", not the "financial" lives, to determine the reasonableness of the price of new services.[84]

In short, the FCC has properly concluded that the "financial" reporting lives or "financial" depreciation rates are not appropriate in calculating a depreciation expense which would be used to set rates charged ratepayers.

**Q. Another type of "depreciation" that Qwest might get in response to it requests are "tax" depreciation or "tax" lives. These are used for income tax purposes. Are "tax" lives determined using the same standards as apply to utility regulatory depreciation?**

A. No. A widely recognized utility regulatory depreciation text warned against such an improper comparison.

[84]Paragraphs 34 and 39, FCC Order 99-397 CC Docket No. 98-137, released December 30, 1999.

Public Utilities Depreciation Practices published by NARUC is the widely accepted public utility depreciation practices text. On page 20, it states:

> It is important to note the difference in purpose of book depreciation and tax depreciation. Book depreciation is a cost allocation process used to satisfy specific accounting and regulatory principles and requirements, whereas tax depreciation provides additional tax and financial incentives unrelated to the strict cost allocation process.[85]

The "tax" lives are calculated on requirements that are very different from the "service lives", which are required for utility regulatory proceedings. For example, the tax code applied a 15-year "tax" life to a rental house that I own.[86] This house is now less than 30 years old, but was fully depreciated for income tax purposes several years ago. This "tax" life is clearly much shorter than the actual life or "service life." In the real world, this house has many decades of service life left before retirement.

At the end of the 15 year tax life, the tax code also assumes this rental house I own has zero market value (zero "net salvage"). In reality, this house has a very significant market value. It is a three-bedroom house (with fireplace) in a good neighborhood.

As the above true example illustrates, "depreciation" can be very different, depending on what standard is used.

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[85] Page 20, Public Utilities Depreciation Practices, NARUC, August, 1996.

[86] 2077 Scarbrough, Springfield, Illinois. Department of the Treasury, Internal Revenue Service, Publication 9946, "How to Depreciate Property." The lives for calculating depreciation for federal income tax purposes for residential rental property generally ranges from 15 years to 27.5 years, depending primarily upon when the property was placed in service. The depreciation rate applies to the building. The lot does not depreciate.

**Q. Are the "lives," "percent reserves," or "net salvage" figures of an IXC, CLEC or CATV company relevant when calculating the utility depreciation rate of a specific account for Qwest in Arizona?**

A. No. The formula we use to calculate the Qwest regulated utility depreciation rate for a specific account is as follows:

Depreciation rate = (100%-(percent reserve)-(future net salvage))/ (avg. remaining life)

The values specific to the specific company and specific account are used in the calculation.

For example the Qwest Arizona "percent reserve" for the buried cable metallic account is 71.1%, and that is what is properly used in the calculation of the Qwest Arizona depreciation rate for that account. If a CLEC or IXC has a 30% reserve in some account, so what? That CLEC's or IXC's "percent reserve" figure is not the correct figure for the Qwest Arizona buried cable metallic account. Likewise, the lives or net salvage figures of an IXC or CLEC do not have any place in the calculation of the Qwest Arizona buried cable metallic depreciation rate.

**Q. Is the equipment, and industry, different for IXCs as compared to LECs?**

A. Yes. The FCC has specifically stated that because of significant differences in these two types of companies, for the IXCs are not comparable to the ILECs for depreciation purposes:

> Additionally, the depreciation practices of IXCs and incumbent LECs are not directly comparable because they use different types of switches and cables.[87]

The FCC further stated,

> ...the underlying conditions that go into estimating the basic factors for interexchange carriers (IXCs) and incumbent LECs are sufficiently different for the two groups that they should be considered differently.[88]

**Q. In addition to the above, why must the "service lives" be used to properly calculate the regulatory depreciation rates, instead of using some "financial reporting" or "tax life"?**

A. The service life must properly be used to calculate the regulatory depreciation rates because that is consistent with how the regulatory utility depreciation rates are applied. The USOA generally requires the depreciation rates apply to the investment all of the time the investment is "in service."[89] If the regulatory depreciation rates were calculated using "financial" or "tax" lives which were different than the "service lives," then those depreciation rates would be inconsistent with the way the depreciation rates will be applied under the USOA. For example, assume an investment will be "in service" ten years before it retires. In order for that investment to fully recover by the time the investment retires, a depreciation rate of 10% might be appropriate.[90] If a 10% depreciation rate applies in each of the ten years the plant is "in service", this will generate depreciation accruals equal to 100% of the investment by the time the investment retires. The investment would be "fully depreciated" when it retired, which is the desired result. However, if the depreciation rate was calculated improperly using a

[87]Paragraph 18, FCC 99-397, December 30, 1999.
[88]Footnote 54, FCC 99-397, December 30, 1999.
[89]USOA, Part 32.2000(g)(2)(iii)
[90]This assumes zero net salvage. This simplified example assumes one unit utilized the ten years.

five year "financial reporting" life, the depreciation rate calculated would be 20%. A 20% depreciation rate applied in each of the ten years of the "service life" before the investment retired would produce 200% in depreciation accruals, which is over-depreciating.[91]

**Q. Can you summarize this issue?**

A. Yes, the "depreciation" information Qwest is trying to obtain from CLECs and IXCs is not relevant in this proceeding for several reasons:

(1) The CLEC/IXC's depreciation rates are not utility regulatory depreciation rates calculated consistent with the USOA/ACC requirements. "Financial reporting" depreciation or "tax" depreciation is not calculated on the USOA/ACC utility regulatory standards.

(2) The IXCs are different than the ILECs, as the FCC has stated.

(3) The "percent reserve" or other parameter used in calculating the depreciation rate for a specific Qwest account should be the Qwest values, not a CLEC's or IXC's values.

(4) There would be a mismatch of the way utility regulated depreciation rates are applied if depreciation rates are calculated on a different standard.

## F. "FUTURE NET SALVAGE" UPDATES

[91]The Company might cease depreciation accruals when the account becomes fully depreciated. In that event, the depreciation rate would be at 20% for the first five years of the service life, and 0% for the last five years of the service life. That would result in over-charging the customers during the first five years, which violates "inter-generational" equity. This would also be contrary to the requirement that depreciation be on the "straight-line method during the service life of the property," as required by USOA. (USOA, §32.2000(g)(i))

**Q. Did you review the "future net salvage" percents of the major accounts?**

A. Yes. I have reviewed the "future net salvage" values for the central office and cable and wire facilities accounts.

The accounts in which the Staff recommends a different future "net salvage" value can be seen in columns J and K of Schedule WDA-12, page 5. The FCC future "net salvage" ranges are shown in columns F and G on that same page. The recent observed net salvage values are shown in columns H and I.

"Future net salvage" is one of the factors (some times called "parameters") used in calculating the depreciation rates.[92] As shown on page 5 of Schedule WDA-12, for eleven accounts, Staff recommends "future net salvage" values that are different than the values currently in use. Most of these changes have a relatively small impact, and eight of the eleven changes are changes that make the depreciation rate higher than it would have been if I had not changed the net salvage value. In other words, eight of these changes are in Qwest's favor. The three salvage changes that have the effect of decreasing the depreciation rate are the change to the Pole Lines account, and the changes to two fiber (non-metallic) cable accounts (non-metallic subaccounts of Accounts 2421, and 2423). In all accounts in which Staff proposes a revised future net salvage value, the value Staff proposes was not above the middle of the FCC "net salvage" range for that account.

[92] The net salvage is the "gross salvage" less the "cost of removal". It is often presented as a percent of original cost. Net salvage can be a negative number or negative percent. For example, if the scrap (or resale) value of a retiring item was $10, but the cost of removing it was $30, that would be a -$20 net salvage. If the original cost of that item was $100, that would be a –20% net salvage (-$20/$100=-20%)

**Q. Please discuss the adjustment to the "future net salvage" in the Pole Line account.**

A. The current value for this account is –138%. Qwest provided data showing the actual net salvage averaged –72.4 % over the years for which data was provided (1983 through 2003). This Qwest provided document is attached as Schedule WDA-13. As also shown on that document, the average net salvage for the last ten years was –87.2%. Both of these figures are significantly different than the –138% value currently in use. The FCC range for this account is –75% to –50%. I selected –75%. This is within the FCC range. This is the most negative of the FCC range (produces a higher depreciation rate than any other value in the range). –75% is near the –72.4% value for all years, and the –87.4% value for the last yen years. Based on the actual Qwest data In Arizona, –75% future net salvage is a much better value than the continued use of –138%.

**Q. Would you please address the adjustment to the "future net salvage" in the non-metallic cable accounts?**

A. Yes. The analysis was similar to what I just described for the Pole Line accounts. Aerial Cable-Non-Metallic is the largest change in net salvage non-metallic account, so I will use it to explain the analysis.

The current prescribed net salvage value for this account is –27%. Qwest provided data showing the actual net salvage averaged -6.8% over the years for which data was provided (1988 through 2003) and the average for the last ten years was -9.3%. The actual data indicated the factor should be adjusted in the positive direction. However the

FCC range for this account is –25% to –10% (with –17.5% as middle of the range), so I could not adjust as far positive as the data indicated, while not going above the middle of the FCC range. I adjusted as positive as I could up to the middle of the FCC range, which was to –17.5%. A more positive number (such as -10%) would have resulted in a lower depreciation rate than I am recommending, but to be conservative, I did not go above the middle of the FCC range.

**Q. What does Staff you recommend pertaining to the depreciation rates in this proceeding?**

A. Staff recommends the depreciation rates shown in Column L of Schedule WDA-12, Page 1, for the reasons discussed above. These depreciation rates are calculated following the USOA/ACC requirements. These depreciation rates are based on the actual Qwest Arizona data and plans.

The "projection lives" Qwest used in its calculations are clearly inconsistent with the actual Qwest Arizona data, as shown on Schedule WDA-19. The retirement amounts Qwest used in its calculation are clearly inconsistent with the actual Qwest Arizona retirements. An example of this is shown on Schedule WDA-6 for the buried cable metallic account.

## V. "PERCENT CONDITION"

**Q. Do the revised depreciation rates that Staff has recommended impact the "percent condition" which is used in the "fair value" rate base calculations?**

A. Yes. Certain values from the depreciation calculations are used in the "percent condition" calculations. The "percent condition" calculations impact the "fair value" rate base, but do not impact the "original cost" rate base calculations.

Schedule WDA-17 shows the "percent condition" values consistent with the depreciation rates proposed by Staff.

**Q. Other than the charges related to the depreciation rates, is there another problem with the "percent condition" values as proposed by Qwest?**

A. Yes. Other than the issues related to the depreciation rates used, there is another problem with Qwest's "percent condition" calculation. In response to request WDA 04-007, Qwest stated that the Qwest "percent condition" calculations were on a "vintage group (VG) basis." However, this Commission uses Equal Life Group (ELG), so the basis of these Qwest calculations was incorrect. In response to WDA 04-009, Qwest acknowledged that the "ELG" remaining life value was the "correct" remaining life, not the "vintage group" (VG) remaining life that Qwest had used in its "percent condition" calculations. I have corrected these problems on Schedule WDA-17, in addition to utilizing the values associated with the Staff recommended depreciation rates.

## VI. CONCLUSION

**Q. Could you summarize your major recommendations?**

A. Yes. For the reasons presented in this testimony:

(1) I recommend the adjustment shown on Schedule WDA-15. This adjustment removes from the intrastate jurisdiction the direct costs of interstate DSL service. This is incorporated into adjustments B-3 and C-6 in the Staff accounting schedules.

(2) I recommend the adjustments shown on Schedule WDA-18. This imputes the construction charges that BSI should have paid to QC for the "video only" USAMs. This is incorporated into adjustments B-4 and C-7 in the Staff accounting schedules.

(3) I recommend the end-of-test-year "percent reserve" values be used in the depreciation rate calculations. Qwest is using the values as of the start of the 2003 test year, but the Commission filing requirements require end-of-test-year values be used. The result of this adjustment is shown in column H of page 1 of Schedule WDA-12. This adjustment is incorporated into adjustment C-22 in the Staff accounting schedules.

(4) I recommend the revised "projection lives" and "future net salvage" values shown in columns E and K of Schedule WDA-12, page 5. This adjustment is incorporated into adjustment C-23 in the Staff accounting schedules.

As a result of items (3) and (4) above, I recommend the depreciation rates shown in Column L of Schedule WDA-12, page 1.

(5) I recommend the "percent condition" values shown on Schedule WDA-17. The "percent condition" calculations impact the "fair value" rate base, but do not impact the "original cost" rate base calculations.

William Dunkel, Consultant
8625 Farmington Cemetery Road
Pleasant Plains, Illinois 62677

Qualifications

The Consultant is a consulting engineer specializing in telecommunication regulatory proceedings. He has participated in over 140 state regulatory proceedings as listed on the attached Relevant Work Experience.

The Consultant has provided cost analysis, rate design, jurisdictional separations, depreciation, expert testimony and other related services to state agencies throughout the country in numerous telecommunication state proceedings. The Consultant has also provided depreciation testimony to state agencies throughout the country in several electric utility proceedings.

The Consultant made a presentation pertaining to Video Dial Tone at the NASUCA 1993 Mid-Year Meeting held in St. Louis.

In addition, the Consultant also made a presentation to the NARUC Subcommittee on Economics and Finance at the NARUC Summer Meetings held in July, 1992. That presentation was entitled "The Reason the Industry Wants to Eliminate Cost Based Regulation--Telecommunications is a Declining Cost Industry."

The Consultant provides services almost exclusively to public agencies, including the Public Utilities Commission, the Public Counsel, or the State Department of Administration in various states.

William Dunkel currently provides, or in the past has provided, services in telecommunications proceedings to the following clients:

The Public Utility Commission or the Staffs in the States of:

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| Arkansas | Mississippi |
| Arizona | Missouri |
| Delaware | New Mexico |
| Georgia | Utah |
| Guam | Virginia |
| Illinois | Washington |
| Maryland | U.S. Virgin Islands |

The Office of the Public Advocate, or its equivalent, in the States of:

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| Colorado | Maryland |
| District of Columbia | Missouri |
| Georgia | New Jersey |
| Hawaii | New Mexico |
| Illinois | Ohio |
| Indiana | Pennsylvania |
| Iowa | Utah |
| Maine | Washington |

The Department of Administration in the States of:

| | |
|---|---|
| Illinois | South Dakota |
| Minnesota | Wisconsin |

In April, 1974, the Consultant was employed by the Illinois Commerce Commission in the Electric Section as a Utility Engineer. In November of 1975, he transferred to the Telephone Section of the Illinois Commerce Commission and from that time until July, 1980, he participated in essentially all telephone rate cases and other telephone rate matters that were set for hearing in the State of Illinois. During that period, he testified as an expert witness in numerous rate design cases and tariff filings in the areas of rate design, cost studies and separations. During the period 1975-1980, he was the Separations and Settlements expert for the Staff of the Illinois Commerce Commission.

From July, 1977 until July, 1980, he was a Staff member of the FCC-State Joint Board on Separations, concerning the "Impact of Customer Provision of Terminal Equipment on Jurisdictional Separations" in FCC Docket No. 20981 on behalf of the Illinois Commerce Commission. The FCC-State Joint Board is the national board which specifies the rules for separations in the telephone industry.

The Consultant has taken the AT&T separations school which is normally provided to the AT&T personnel.

The Consultant has taken the General Telephone separations school which is normally provided for training of the General Telephone Company personnel in separations.

Since July, 1980 he has been regularly employed as an independent consultant in telephone rate proceedings across the nation.

He has testified before the Illinois House of Representatives Subcommittee on Communications, as well as participating in numerous other schools and conferences pertaining to the utility industry.

Prior to employment at the Illinois Commerce Commission, the Consultant was a design engineer for Sangamo Electric Company designing electric watt-hour meters used in the electric utility industry. The Consultant was granted patent No. 3822400 for a solid state meter pulse initiator.

The Consultant graduated from the University of Illinois in February, 1970 with a Bachelor's of Science Degree in Engineering Physics with emphasis on economics and other business-related subjects. The Consultant has taken several post-graduate courses since graduation.

RELEVANT WORK EXPERIENCE OF
WILLIAM DUNKEL

| | |
|---|---|
| ALASKA | |
| - ACS | |
| General rate case | Docket Nos. U-01-83, U-01-85, U-01-87 |
| AFOR proceeding | Docket No. R-03-003 |
| - All Companies | |
| Access charge proceeding | Docket No. R-01-001 |
| ARIZONA | |
| - U.S. West Communications | Cost of Service Study |
| Wholesale cost/UNE case | Docket No. T-00000A-00-0194 |
| General rate case | Docket No. E-1051-93-183 |
| Depreciation case | Docket No. T-01051B-97-0689 |
| General rate case | Docket No. T-01051B-99-0105 |
| ARKANSAS | |
| - Southwestern Bell Telephone Company | Docket No. 83-045-U |
| CALIFORNIA | |
| (on behalf of the Office of Ratepayer Advocates (ORA)) | |
| - Kerman Telephone General Rate Case | A.02-01-004 |
| (on behalf of the California Cable Television Association) | |
| - General Telephone of California | I.87-11-033 |
| - Pacific Bell | |
| Fiber Beyond the Feeder Pre-Approval Requirement | |
| COLORADO | |
| - Mountain Bell Telephone Company | |
| General Rate Case | Docket No. 96A-218T et al. |
| Call Trace Case | Docket No. 92S-040T |
| Caller ID Case | Docket No. 91A-462T |
| General Rate Case | Docket No. 90S-544T |
| Local Calling Area Case | Docket No. 1766 |
| General Rate Case | Docket No. 1720 |
| General Rate Case | Docket No. 1700 |
| General Rate Case | Docket No. 1655 |
| General Rate Case | Docket No. 1575 |
| Measured Services Case | Docket No. 1620 |
| - Independent Telephone Companies | |

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| Cost Allocation Methods Case | Docket No. 89R-608T |
| DELAWARE | |
| - Diamond State Telephone Company | |
| General Rate Case | PSC Docket No. 82-32 |
| General Rate Case | PSC Docket No. 84-33 |
| Report on Small Centrex | PSC Docket No. 85-32T |
| General Rate Case | PSC Docket No. 86-20 |
| Centrex Cost Proceeding | PSC Docket No. 86-34 |
| DISTRICT OF COLUMBIA | |
| - C&P Telephone Company of D.C. | |
| Depreciation issues | Formal Case No. 926 |
| FCC | |
| - Review of jurisdictional separations | FCC Docket No. 96-45 |
| - Developing a Unified Intercarrier Compensation Regime | CC Docket No. 01-92 |
| FLORIDA | |
| - BellSouth, GTE, and Sprint | |
| Fair and reasonable rates | Undocketed Special Project |
| GEORGIA | |
| - Southern Bell Telephone & Telegraph Co. | |
| General Rate Proceeding | Docket No. 3231-U |
| General Rate Proceeding | Docket No. 3465-U |
| General Rate Proceeding | Docket No. 3286-U |
| General Rate Proceeding | Docket No. 3393-U |
| HAWAII | |
| - GTE Hawaiian Telephone Company | |
| Depreciation/separations issues | Docket No. 94-0298 |
| Resale case | Docket No. 7702 |
| ILLINOIS | |
| - Commonwealth Edison Company | |
| General Rate Proceeding | Docket No. 80-0546 |
| General Rate Proceeding | Docket No. 82-0026 |
| Section 50 | Docket No. 59008 |
| Section 55 | Docket No. 59064 |

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| Section 50 | Docket No. 59314 |
| Section 55 | Docket No. 59704 |
| - Central Illinois Public Service | |
| Section 55 | Docket No. 58953 |
| Section 55 | Docket No. 58999 |
| Section 55 | Docket No. 59000 |
| Exchange of Facilities (Illinois Power) | Docket No. 59497 |
| General Rate Increase | Docket No. 59784 |
| Section 55 | Docket No. 59677 |
| - South Beloit | |
| General Rate Case | Docket No. 59078 |
| - Illinois Power | |
| Section 55 | Docket No. 59281 |
| Interconnection | Docket No. 59435 |
| - Verizon North Inc. and Verizon South Inc. | Docket No. 02-0560 |
| DSL Waiver Petition Proceeding | |
| - Geneseo Telephone Company | |
| EAS case | Docket No. 99-0412 |
| - Central Telephone Company | |
| (Staunton merger) | Docket No. 78-0595 |
| - General Telephone & Electronics Co. | |
| Usage sensitive service case | Docket Nos. 98-0200/98-0537 |
| General rate case (on behalf of CUB) | Docket No. 93-0301 |
| (Usage sensitive rates) | Docket No. 79-0141 |
| (Data Service) | Docket No. 79-0310 |
| (Certificate) | Docket No. 79-0499 |
| (Certificate) | Docket No. 79-0500 |
| - General Telephone Co. | Docket No. 80-0389 |
| - SBC | |
| Imputation Requirement | Docket No. 04-0461 |
| Implement UNE Law | Docket No. 03-0323 |
| UNE Rate Case | Docket No. 02-0864 |
| Alternative Regulation Review | Docket No. 98-0252 |
| - Ameritech (Illinois Bell Telephone Company) | |
| Area code split case | Docket No. 94-0315 |
| General Rate Case | Docket No. 83-0005 |
| (Centrex filing) | Docket No. 84-0111 |
| General Rate Proceeding | Docket No. 81-0478 |
| (Call Lamp Indicator) | Docket No. 77-0755 |
| (Com Key 1434) | Docket No. 77-0756 |
| (Card dialers) | Docket No. 77-0757 |
| (Concentration Identifier) | Docket No. 78-0005 |

| | |
|---|---|
| (Voice of the People) | Docket No. 78-0028 |
| (General rate increase) | Docket No. 78-0034 |
| (Dimension) | Docket No. 78-0086 |
| (Customer controlled Centrex) | Docket No. 78-0243 |
| (TAS) | Docket No. 78-0031 |
| (Ill. Consolidated Lease) | Docket No. 78-0473 |
| (EAS Inquiry) | Docket No. 78-0531 |
| (Dispute with GTE) | Docket No. 78-0576 |
| (WUI vs. Continental Tel.) | Docket No. 79-0041 |
| (Carle Clinic) | Docket No. 79-0132 |
| (Private line rates) | Docket No. 79-0143 |
| (Toll data) | Docket No. 79-0234 |
| (Dataphone) | Docket No. 79-0237 |
| (Com Key 718) | Docket No. 79-0365 |
| (Complaint - switchboard) | Docket No. 79-0380 |
| (Porta printer) | Docket No. 79-0381 |
| (General rate case) | Docket No. 79-0438 |
| (Certificate) | Docket No. 79-0501 |
| (General rate case) | Docket No. 80-0010 |
| (Other minor proceedings) | Docket No. various |
| - Home Telephone Company | Docket No. 80-0220 |
| - Northwestern Telephone Company | |
| Local and EAS rates | Docket No. 79-0142 |
| EAS | Docket No. 79-0519 |

INDIANA

| | |
|---|---|
| - Public Service of Indiana (PSI) | |
| Depreciation issues | Cause No. 39584 |
| - Indianapolis Power and Light Company | |
| Depreciation issues | Cause No. 39938 |

IOWA

| | |
|---|---|
| - U S West Communications, Inc. | |
| Local Exchange Competition | Docket No. RMU-95-5 |
| Local Network Interconnection | Docket No. RPU-95-10 |
| General Rate Case | Docket No. RPU-95-11 |

KANSAS

| | |
|---|---|
| - Southwestern Bell Telephone Company | |
| Commission Investigation of the KUSF | Docket No. 98-SWBT-677-GIT |
| - Rural Telephone Service Company | |
| Audit and General rate proceeding | Docket No. 00-RRLT-083-AUD |

| | |
|---|---|
| Request for supplemental KUSF | Docket No. 00-RRLT-518-KSF |
| - Southern Kansas Telephone Company | |
| Audit and General rate proceeding | Docket No. 01-SNKT-544-AUD |
| - Pioneer Telephone Company | |
| Audit and General rate proceeding | Docket No. 01-PNRT-929-AUD |
| - Craw-Kan Telephone Cooperative, Inc. | |
| Audit and General rate proceeding | Docket No. 01-CRKT-713-AUD |
| - Sunflower Telephone Company, Inc. | |
| Audit and General rate proceeding | Docket No. 01-SFLT-879-AUD |
| - Bluestem Telephone Company, Inc. | |
| Audit and General rate proceeding | Docket No. 01-BSST-878-AUD |
| - Home Telephone Company, Inc. | |
| Audit and General rate proceeding | Docket No. 02-HOMT-209-AUD |
| - Wilson Telephone Company, Inc. | |
| Audit and General rate proceeding | Docket No. 02-WLST-210-AUD |
| - S&T Telephone Cooperative Association, Inc. | |
| Audit and General rate proceeding | Docket No. 02-S&TT-390-AUD |
| - Blue Valley Telephone Company, Inc. | |
| Audit and General rate proceeding | Docket No. 02-BLVT-377-AUD |
| - JBN Telephone Company | |
| Audit and General rate proceeding | Docket No. 02-JBNT-846-AUD |
| - S&A Telephone Company | |
| Audit and General rate proceeding | Docket No. 03-S&AT-160-AUD |
| - Wheat State Telephone Company, Inc. | |
| Audit and General rate proceeding | Docket No. 03-WHST-503-AUD |
| - Haviland Telephone Company, Inc. | |
| Audit and General rate proceeding | Docket No. 03-HVDT-664-RTS |
| - Twin Valley Telephone, Inc. | |
| Audit and General rate proceeding | Docket No. 03-TWVT-1031-AUD |
| - Golden Belt Telephone Association | |
| Audit and General rate proceeding | Docket No. 04-GNBT-130-AUD |

MAINE

| | |
|---|---|
| - New England Telephone Company | |
| General rate proceeding | Docket No. 92-130 |

MARYLAND

| | |
|---|---|
| - Chesapeake and Potomac Telephone Company | |
| General rate proceeding | Docket No. 7851 |
| Cost Allocation Manual Case | Case No. 8333 |
| Cost Allocation Issues Case | Case No. 8462 |
| - Verizon Maryland | |

| | | |
|---|---|---|
| | PICC rate case | Case No. 8862 |
| | USF case | Case No. 8745 |
| - | Washington Gas Light Company | |
| | Depreciation Rate Case | Case No. 8960 |

MINNESOTA

| | | |
|---|---|---|
| - | Access charge (all companies) | Docket No. P-321/CI-83-203 |
| - | U. S. West Communications, Inc. (Northwestern Bell Telephone Co.) | |
| | Centrex/Centron proceeding | Docket No. P-421/91-EM-1002 |
| | General rate proceeding | Docket No. P-321/M-80-306 |
| | Centrex Dockets | MPUC No. P-421/M-83-466 |
| | | MPUC No. P-421/M-84-24 |
| | | MPUC No. P-421/M-84-25 |
| | | MPUC No. P-421/M-84-26 |
| | General rate proceeding | MPUC No. P-421/GR-80-911 |
| | General rate proceeding | MPUC No. P-421/GR-82-203 |
| | General rate case | MPUC No. P-421/GR-83-600 |
| | WATS investigation | MPUC No. P-421/CI-84-454 |
| | Access charge case | MPUC No. P-421/CI-85-352 |
| | Access charge case | MPUC No. P-421/M-86-53 |
| | Toll Compensation case | MPUC No. P-999/CI-85-582 |
| | Private Line proceeding | Docket No. P-421/M-86-508 |
| - | AT&T | |
| | Intrastate Interexchange | Docket No. P-442/M-87-54 |

MISSISSIPPI

| | | |
|---|---|---|
| - | South Central Bell | |
| | General rate filing | Docket No. U-4415 |

MISSOURI

| | | |
|---|---|---|
| - | Southwestern Bell | |
| | General rate proceeding | TR-79-213 |
| | General rate proceeding | TR-80-256 |
| | General rate proceeding | TR-82-199 |
| | General rate proceeding | TR-86-84 |
| | General rate proceeding | TC-89-14, et al. |
| | Alternative Regulation | TC-93-224/TO-93-192 |
| - | United Telephone Company | |
| | Depreciation proceeding | TR-93-181 |
| - | All companies | |
| | Extended Area Service | TO-86-8 |

| | |
|---|---|
| EMS investigation | TO-87-131 |
| Cost of Access Proceeding | TR-2001-65 |

NEW JERSEY

| | |
|---|---|
| - New Jersey Bell Telephone Company | |
| General rate proceeding | Docket No. 802-135 |
| General rate proceeding | BPU No. 815-458 |
| | OAL No. 3073-81 |
| Phase I - General rate case | BPU No. 8211-1030 |
| | OAL No. PUC10506-82 |
| General rate case | BPU No. 848-856 |
| | OAL No. PUC06250-84 |
| Division of regulated | BPU No. TO87050398 |
| from competitive services | OAL No. PUC 08557-87 |
| Customer Request Interrupt | Docket No. TT 90060604 |

NEW MEXICO

| | |
|---|---|
| - U.S. West Communications, Inc. | |
| E-911 proceeding | Docket No. 92-79-TC |
| General rate proceeding | Docket No. 92-227-TC |
| General rate/depreciation proceeding | Case No. 3008 |
| Subsidy Case | Case No. 3325 |
| USF Case | Case No. 3223 |
| - VALOR Communications | |
| Subsidy Case | Case No. 3300 |

OHIO

| | |
|---|---|
| - Ohio Bell Telephone Company | |
| General rate proceeding | Docket No. 79-1184-TP-AIR |
| General rate increase | Docket No. 81-1433-TP-AIR |
| General rate increase | Docket No. 83-300-TP-AIR |
| Access charges | Docket No. 83-464-TP-AIR |
| - General Telephone of Ohio | |
| General rate proceeding | Docket No. 81-383-TP-AIR |
| - United Telephone Company | |
| General rate proceeding | Docket No. 81-627-TP-AIR |

OKLAHOMA

| | |
|---|---|
| - Public Service of Oklahoma | |
| Depreciation case | Cause No. 96-0000214 |

PENNSYLVANIA

| | | |
|---|---|---|
| - | GTE North, Inc. | |
| | Interconnection proceeding | Docket No. A-310125F002 |
| - | Bell Telephone Company of Pennsylvania | |
| | Alternative Regulation proceeding | Docket No. P-00930715 |
| | Automatic Savings | Docket No. R-953409 |
| | Rate Rebalance | Docket No. R-00963550 |
| - | Enterprise Telephone Company | |
| | General rate proceeding | Docket No. R-922317 |
| - | All companies | |
| | InterLATA Toll Service Invest. | Docket No. I-910010 |
| | Joint Petition for Global Resolution of Telecommunications Proceedings | Docket Nos. P-00991649, P-00991648, M-00021596 |
| - | GTE North and United Telephone Company | |
| | Local Calling Area Case | Docket No. C-902815 |
| - | Verizon | |
| | Joint Application of Bell Atlantic and GTE for Approval of Agreement and Plan of Merger | Docket Nos. A-310200F0002, A-311350F0002, A-310222F0002, A-310291F0003 |
| | Access Charge Complaint Proceeding | Docket No. C-200271905 |

SOUTH DAKOTA

| | | |
|---|---|---|
| - | Northwestern Bell Telephone Company | |
| | General rate proceeding | Docket No. F-3375 |

TENNESSEE

(on behalf of Time Warner Communications)

| | | |
|---|---|---|
| - | BellSouth Telephone Company | |
| | Avoidable costs case | Docket No. 96-00067 |

UTAH

| | | |
|---|---|---|
| - | U.S. West Communications (Mountain Bell Telephone Company) | |
| | General rate case | Docket No. 84-049-01 |
| | General rate case | Docket No. 88-049-07 |
| | 800 Services case | Docket No. 90-049-05 |
| | General rate case/ incentive regulation | Docket No. 90-049-06/90-049-03 |
| | General rate case | Docket No. 92-049-07 |
| | General rate case | Docket No. 95-049-05 |
| | General rate case | Docket No. 97-049-08 |
| | Qwest Price Flexibility-Residence | Docket No. 01-2383-01 |
| | Qwest Price Flexibility-Business | Docket No. 02-049-82 |
| | Qwest Price Flexibility-Residence | Docket No. 03-049-49 |

| Qwest Price Flexibility-Business | Docket No. 03-049-50 |
|---|---|
| VIRGIN ISLANDS, U.S. | |
| - Virgin Islands Telephone Company | |
| General rate case | Docket No. 264 |
| General rate case | Docket No. 277 |
| General rate case | Docket No. 314 |
| General rate case | Docket No. 316 |
| VIRGINIA | |
| - General Telephone Company of the South | |
| Jurisdictional allocations | Case No. PUC870029 |
| Separations | Case No. PUC950019 |
| WASHINGTON | |
| - US West Communications, Inc. | |
| Interconnection case | Docket No. UT-960369 |
| General rate case | Docket No. UT-950200 |
| - All Companies- | Analyzed the local calling areas in the State |
| WISCONSIN | |
| - Wisconsin Bell Telephone Company | |
| Private line rate proceeding | Docket No. 6720-TR-21 |
| General rate proceeding | Docket No. 6720-TR-34 |

Arizona
T-01051B-03-0454 and T-00000D-00-0672
WDA 04-006

INTERVENOR: William W. Dunkel and Associates

REQUEST NO: 006

In response to WDA 02-002, Qwest states that it does not recognize the "2003 State Depreciation Rates" workpaper referenced. Attached is a copy of the file. The first tab of this document is the entitled "Booked Results". The first line of this document is "COMPOSITE DEPRECIATION RATES (%) STATE (INTRASTATE) Booked Results". The footer on this document indicates "Jim Jones".

a. Is there a Jim Jones who works with depreciation for Qwest or on behalf of Qwest?

b. Does Qwest acknowledge that someone working for Qwest or on behalf of Qwest prepared the Excel spreadsheet attached?

c. Does Qwest acknowledge that Qwest provided that Excel spreadsheet to Staff and/or Staff consultants in response to a data request as a non-confidential document?

d. If Qwest denies any of the prior parts of this request, please provide a full explanation of why Qwest disagrees with that statement, and provide the corrected statement.

RESPONSE:

a. Yes.

b. Yes.

c. Qwest provided the data to Utilitech (Michael Brosch) as part of an information request.

d. Please see responses to (a), (b), and (c).

Respondent: Dennis Wu

# QWEST CORPORATION

COMPOSITE DEPRECIATION RATES (%) STATE (INTRASTATE) Booked Results

| Year | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| New Mexico | 7.3 | 7.4 | 7.9 | 7.7 | 7.5 | 7.5 | 6.4 | 6.3 | 6.3 | 6.0 | 6.0 | 6.0 |
| Oregon | 5.8 | 5.9 | 6.3 | 6.1 | 7.5 | 7.5 | 7.0 | 6.9 | 6.8 | 6.6 | 6.6 | 6.7 |
| Utah | 6.2 | 6.3 | 6.6 | 7.9 | 8.4 | 8.2 | 6.9 | 7.2 | 6.5 | 6.5 | 6.8 | 6.7 |
| Washington | 6.0 | 6.5 | 6.3 | 6.3 | 6.3 | 6.6 | 6.6 | 6.2 | 5.7 | 5.9 | 6.0 | 6.1 |
| Minnesota | 7.2 | 7.0 | 7.3 | 8.2 | 8.4 | 8.3 | 6.2 | 8.1 | 7.4 | 7.7 | 7.8 | 7.2 |
| Colorado | 8.0 | 7.4 | 8.9 | 8.6 | 8.6 | 8.6 | 7.2 | 7.1 | 7.1 | 7.1 | 6.4 | 5.6 |
| South Dakota | 5.9 | 6.5 | 6.5 | 6.5 | 8.1 | 8.1 | 7.4 | 6.9 | 7.3 | 7.4 | 7.5 | 7.3 |
| Arizona | 7.2 | 7.2 | 7.3 | 7.3 | 7.3 | 7.3 | 6.8 | 6.3 | 8.3 | 9.2 | 9.4 | 9.5 |
| Iowa | 7.5 | 6.2 | 6.5 | 6.7 | 6.7 | 6.7 | 6.7 | 6.5 | 6.7 | 6.8 | 6.7 | 6.9 |
| Montana | 5.7 | 6.2 | 6.5 | 6.0 | 6.2 | 6.4 | 6.7 | 8.7 | 7.5 | 6.3 | 6.3 | 6.4 |
| Wyoming | 6.2 | 6.3 | 6.6 | 6.2 | 6.4 | 6.4 | 7.3 | 7.3 | 7.4 | 7.6 | 7.8 | 7.8 |
| Nebraska | 7.7 | 8.9 | 8.7 | 8.5 | 9.3 | 9.3 | 8.1 | 8.0 | 7.9 | 8.0 | 7.9 | 6.3 |
| North Dakota | 6.2 | 6.0 | 6.4 | 6.3 | 7.6 | 8.1 | 8.2 | 8.0 | 7.7 | 6.8 | 6.9 | 6.9 |
| So. Idaho | 4.5 | 7.2 | 7.7 | 7.2 | 7.3 | 7.4 | 8.9 | 8.3 | 8.0 | 7.5 | 7.9 | 7.6 |
| No. Idaho | 6.8 | 6.8 | 6.5 | 6.4 | 6.4 | 7.9 | 7.9 | 7.5 | 7.7 | 7.7 | 7.0 | 7.4 |
| QC (exluding Malheur) | | | | | | | | 7.0 | 7.1 | 7.2 | 7.2 | 6.9 |

Notes:

Arizona
T-01051B-03-0454
WDA 02-005

INTERVENOR: William W. Dunkel and Associates

REQUEST NO: 005

The Qwest response to Dunkel 01-010 provided a "technical update" as of 12/31/03. That response indicates that the vintage "retirement adjustments" referred to in Dunkel Request No. 1.7 were not included.

(a) Please provide a copy of this "technical update" as of 12/31/03, with the vintage "retirement adjustments" included.

(b) Is it correct that only changes need to adjust this "technical update" as of 12/31/03, to include the vintage "retirement adjustments" would be to (1) reduce the UG Cable Metallic Investment and Depreciation reserve amounts by $9,923,(000) (2) reduce the Buried Cable Metallic Investment and Depreciation reserve amounts by $15,939,(000), (3) reduce the Intra-building Metallic Investment and Depreciation reserve amounts by $3,128,(000), and carry the impact of these above changes through the calculations. (These figure are for the 1925 vintages as of 12/31/2003, according to data provided by Qwest in response to Dunkel Request 01-001.)

(c) If you do not agree with the statement in part (b), then provide each of the adjustments, and the amount to be used in each of those adjustments, to adjust this "technical update" as of 12/31/03, to include the vintage "retirement adjustments".

RESPONSE:

(a) Please see Non-Confidential Attachment A.

(b) Yes.

(c) See response to (b).

Respondent: Dennis Wu

DOCKET NO. T-01051B-03-0454
& T-00000D-00-0672
WDA 02-005 (a)
ATTACHMENT: A

'18/04
-:51 AM
XREF: 09
PRES: 1997,SF,02
PROP: 2004,SG,02
PRESCRIBED PARAMETERS

COMPANY: QWEST CORPORATION
STATE: ARIZONA
ACCOUNT: STATEMENT A
PAGE 1 OF 1

SUMMARY OF DEPRECIATION RATES
ALL VINTAGE RECOVERY

| | | DEPRECIATION RATES IN EFFECT 12/31/2003 | | | | RATES EFFECTIVE IN 2004 | | | |
|---|---|---|---|---|---|---|---|---|---|
| ACCOUNT NUMBER | CLASS OR SUBCLASS OF PLANT | REM LIFE YEARS | RESERVE % | FUTURE NET SALVAGE % | RATE % | REM LIFE YEARS | RESERVE % | FUTURE NET SALVAGE % | RATE % |
| | | A | B | C | D | E | F | G | H |
| 2112 | MOTOR VEHICLES | 3.6 | 66.4 | 16.0 | 4.9 | 3.8 | 57.7 | 16.0 | 6.9 |
| 2114 | SPEC PURPOSE VEHICLE | 9.8 | 0.0 | 0.0 | 10.2 | 4.4 | 43.9 | 0.0 | 12.8 |
| 2115 | GARAGE WORK EQUIP | 10.2 | -55.1 | -4.0 | 15.6 | 9.1 | -17.2 | -4.0 | 13.3 |
| 2116 | OTHER WORK EQUIP | 5.4 | 7.2 | 7.0 | 15.9 | 6.7 | 44.6 | 7.0 | 7.2 |
| 2121 | BUILDINGS | 26.0 | 29.2 | -6.0 | 3.0 | 24.0 | 27.6 | -6.0 | 3.3 |
| 2122 | FURNITURE | 5.5 | -10.8 | 0.0 | 20.1 | 6.8 | 72.6 | 0.0 | 4.0 |
| 2123.1 | OFFICE EQUIPMENT | 3.3 | 26.3 | 0.0 | 22.3 | 2.5 | 102.4 | 0.0 | 0.0 |
| 2123.2 | COMPANY COMM EQUIP | 5.3 | 67.7 | 0.0 | 6.1 | 4.6 | 92.3 | 0.0 | 1.7 |
| 2124 | GEN PURPOSE CMPTR | 2.4 | 72.4 | 5.0 | 9.4 | 1.7 | 95.9 | 5.0 | 0.0 |
| 2212 | DIGITAL SW EQUIP | 5.4 | 37.5 | 3.0 | 11.0 | 5.2 | 54.9 | 3.0 | 8.1 |
| 2220 | OPERATOR SYSTEMS | 4.1 | 96.6 | -3.0 | 1.6 | 3.8 | 5.1 | -3.0 | 25.8 |
| 2231 | RADIO SYSTEMS | 6.6 | 64.0 | -2.0 | 5.8 | 5.0 | 98.3 | -2.0 | 0.7 |
| 2232 | CIRCUIT EQUIP | | | | | | | | |
| | CIRCUIT DDS | 4.0 | 75.4 | 3.0 | 5.4 | 3.4 | 90.2 | 3.0 | 2.0 |
| | CIRCUIT DIGITAL | 5.1 | 47.8 | 2.0 | 9.8 | 5.3 | 60.6 | 2.0 | 7.1 |
| | CIRCUIT ANALOG | 3.3 | 89.3 | 0.0 | 3.2 | 2.8 | 101.3 | 0.0 | 0.0 |
| ?362 | OTHER TERM EQUIP | 6.4 | 49.9 | 2.0 | 7.5 | 6.5 | 56.4 | 2.0 | 6.4 |
| 11 | POLE LINES | 26.0 | 71.6 | -138.0 | 6.4 | 25.0 | 90.3 | -138.0 | 5.9 |
| -421 | AERIAL CABLE MET | 5.2 | 61.5 | -27.0 | 12.6 | 5.0 | 104.9 | -27.0 | 4.4 |
| 2421 | AERIAL CABLE NON MET | 13.1 | 12.5 | -27.0 | 8.7 | 8.7 | 44.0 | -27.0 | 9.5 |
| 2422 | UNDGRD CABLE MET | 5.8 | 50.8 | -6.0 | 9.5 | 5.6 | 83.1 | -6.0 | 4.1 |
| 2422 | UNDGRD CABLE NON MET | 7.7 | 26.5 | -6.0 | 10.3 | 6.8 | 49.7 | -6.0 | 8.3 |
| 2423 | BURIED CABLE MET | 5.6 | 40.0 | -7.0 | 12.0 | 5.4 | 71.7 | -7.0 | 6.5 |
| 2423 | BURIED CABLE NON MET | 12.9 | 24.8 | -7.0 | 6.4 | 8.7 | 49.3 | -7.0 | 6.6 |
| 2424 | SUB CABLE MET | 1.4 | -20.6 | 0.0 | 86.1 | 0.5 | 121.6 | 0.0 | 0.0 |
| 2424 | SUB CABLE NON MET | 9.0 | 0.0 | 0.0 | 11.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| 2426 | INTRA BLDG CA MET | 8.3 | 70.7 | 0.0 | 3.5 | 8.1 | 76.8 | 0.0 | 2.9 |
| 2426 | INTRA BLDG NON MET | 6.1 | 20.2 | 0.0 | 13.1 | 6.2 | 61.2 | 0.0 | 6.3 |
| 2431 | AERIAL WIRE | 5.5 | 16.8 | -30.0 | 20.6 | 5.3 | 90.5 | -30.0 | 7.5 |
| 2441 | CONDUIT SYSTEMS | 44.0 | 21.1 | -20.0 | 2.2 | 43.0 | 23.8 | -20.0 | 2.2 |

DIGITAL SW RESERVE ADJ FOR RESIDUAL ANALOG SW, SXS, & XBR - UCB, BCB, NCB 1925 VINTAGE INVESTMENT EXCLUDED

ATTACHMENT "A"
AZ-DOC. NO. T-0151B-03-0454
WDA SET 2, NO.02 – 05 a.



/18/04
.2:51 AM
XREF: 09
PRES: 1997,SF,02
PROP: 2004,SG,02
PRESCRIBED PARAMETERS

COMPANY: QWEST CORPORATION
STATE: ARIZONA
ACCOUNT: STATEMENT B
PAGE 1 OF 1

CHANGE IN ANNUAL DEPRECIATION ACCRUALS
RESULTING FROM CHANGES IN DEPRECIATION RATES
INTRA STATE FACTORS APPLIED ($000)

| | | | RATES EFFECTIVE 12/31/2003 | | | RATES EFFECTIVE IN 2004 | | | |
|---|---|---|---|---|---|---|---|---|---|
| ACCOUNT NUMBER | CLASS OR SUBCLASS OF PLANT | INVESTMENT 1/1/04 | RATE AMOUNT | AMORT AMOUNT | TOTAL | RATE AMOUNT | AMORT AMOUNT | TOTAL | CHANGE IN ACCRUALS |
| | | I | J=D*I | K | L=J+K | M=H*I | N | O=M+N | P=O-L |
| 2112 | MOTOR VEHICLES | 50,002 | 2,450 | 0 | 2,450 | 3,450 | 0 | 3,450 | 1,000 |
| 2114 | SPEC PURPOSE VEHICLE | 18 | 2 | 0 | 2 | 2 | 0 | 2 | 0 |
| 2115 | GARAGE WORK EQUIP | 1,075 | 168 | 0 | 168 | 143 | 0 | 143 | -25 |
| 2116 | OTHER WORK EQUIP | 27,124 | 4,313 | 0 | 4,313 | 1,953 | 0 | 1,953 | -2,360 |
| 2121 | BUILDINGS | 168,555 | 5,057 | 0 | 5,057 | 5,562 | 0 | 5,562 | 505 |
| 2122 | FURNITURE | 1,253 | 252 | 0 | 252 | 50 | 0 | 50 | -202 |
| 2123.1 | OFFICE EQUIPMENT | 4,186 | 933 | 0 | 933 | 0 | 0 | 0 | -933 |
| 2123.2 | COMPANY COMM EQUIP | 1,719 | 105 | 0 | 105 | 29 | 0 | 29 | -76 |
| 2124 | GEN PURPOSE CMPTR | 68,171 | 6,408 | 0 | 6,408 | 0 | 0 | 0 | -6,408 |
| 2212 | DIGITAL SW EQUIP | 899,493 | 98,944 | 0 | 98,944 | 72,859 | 0 | 72,859 | -26,085 |
| 2220 | OPERATOR SYSTEMS | 1,962 | 31 | 0 | 31 | 506 | 0 | 506 | 475 |
| 2231 | RADIO SYSTEMS | 20,998 | 1,218 | 0 | 1,218 | 147 | 0 | 147 | -1,071 |
| 2232 | CIRCUIT EQUIP | | | | | | | | |
| | CIRCUIT DDS | 3,517 | 190 | 0 | 190 | 70 | 0 | 70 | -120 |
| | CIRCUIT DIGITAL | 1,084,182 | 106,250 | 0 | 106,250 | 76,977 | 0 | 76,977 | -29,273 |
| | CIRCUIT ANALOG | 25,342 | 811 | 0 | 811 | 0 | 0 | 0 | -811 |
| 2362 | OTHER TERM EQUIP | 51,022 | 3,827 | 0 | 3,827 | 3,265 | 0 | 3,265 | -562 |
| 11 | POLE LINES | 38,664 | 2,474 | 0 | 2,474 | 2,281 | 0 | 2,281 | -193 |
| .421 | AERIAL CABLE MET | 145,482 | 18,331 | 0 | 18,331 | 6,401 | 0 | 6,401 | -11,930 |
| 2421 | AERIAL CABLE NON MET | 6,840 | 595 | 0 | 595 | 650 | 0 | 650 | 55 |
| 2422 | UNDGRD CABLE MET | 284,540 | 27,031 | 0 | 27,031 | 11,666 | 0 | 11,666 | -15,365 |
| 2422 | UNDGRD CABLE NON MET | 133,505 | 13,751 | 0 | 13,751 | 11,081 | 0 | 11,081 | -2,670 |
| 2423 | BURIED CABLE MET | 1,194,457 | 143,335 | 0 | 143,335 | 77,640 | 0 | 77,640 | -65,695 |
| 2423 | BURIED CABLE NON MET | 17,322 | 1,109 | 0 | 1,109 | 1,143 | 0 | 1,143 | 34 |
| 2424 | SUB CABLE MET | 2 | 2 | 0 | 2 | 0 | 0 | 0 | -2 |
| 2424 | SUB CABLE NON MET | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 2426 | INTRA BLDG CA MET | 31,784 | 1,112 | 0 | 1,112 | 922 | 0 | 922 | -190 |
| 2426 | INTRA BLDG NON MET | 773 | 101 | 0 | 101 | 49 | 0 | 49 | -52 |
| 2431 | AERIAL WIRE | 8,069 | 1,662 | 0 | 1,662 | 605 | 0 | 605 | -1,057 |
| 2441 | CONDUIT SYSTEMS | 330,286 | 7,266 | 0 | 7,266 | 7,266 | 0 | 7,266 | 0 |
| | TOTALS | 4,600,343 | 447,728 | 0 | 447,728 | 284,717 | 0 | 284,717 | -163,011 |
| | COMPOSITES | | | | 9.7 | | | 6.2 | |

DIGITAL SW RESERVE ADJ FOR RESIDUAL ANALOG SW, SXS, & XBR - UCB, BCB, NCB 1925 VINTAGE INVESTMENT EXCLUDED

ATTACHMENT "A"
AZ-DOC. NO. T-0151B-03-0454
WDA SET 2, NO.02 – 05 a..



6/18/04
12:51 AM
XREF: 09
PRES: 1997,SF,02
PROP: 2004,SG,02
PRESCRIBED PARAMETERS

COMPANY: QWEST CORPORATION
STATE: ARIZONA
ACCOUNT: STATEMENT C - RESERVES
PAGE 1 OF 1

SUMMARY OF RESERVES (INTRA STATE FACTORS APPLIED) 1-1-2004

| ACCOUNT | CATEGORY | 1-1-2004 INVESTMENT | BOOK RESERVE AMOUNT | BOOK RESERVE PERCENT | AVERAGE SERVICE LIFE | AVERAGE REM LIFE | AVERAGE NET SALVAGE | FUTURE NET SALVAGE | THEORETICAL RESERVE AMOUNT | THEORETICAL RESERVE PERCENT |
|---|---|---|---|---|---|---|---|---|---|---|
| | | A$ | B$ | C=B/A | D | E | F | G | H$ | I |
| 2112 | MOTOR VEHICLES | 50,002,464 | 28,870,369 | 57.7 | 9.2 | 3.8 | 15 | 16 | 24,451,205 | 48.9 |
| 2114 | SPEC PURPOSE VEHICLE | 18,258 | 8,024 | 43.9 | 14.9 | 4.4 | 0 | 0 | 12,872 | 70.5 |
| 2115 | GARAGE WORK EQUIP | 1,074,994 | -184,705 | -17.2 | 13.6 | 9.1 | -24 | -4 | 225,749 | 21.0 |
| 2116 | OTHER WORK EQUIP | 27,123,901 | 12,101,709 | 44.6 | 10.8 | 6.7 | 9 | 7 | 9,900,224 | 36.5 |
| 2121 | BUILDINGS | 168,555,110 | 46,482,803 | 27.6 | 34.0 | 24.0 | 2 | -6 | 62,028,280 | 36.8 |
| 2122 | FURNITURE | 1,253,232 | 910,003 | 72.6 | 13.4 | 6.8 | 3 | 0 | 636,642 | 50.8 |
| 2123.1 | OFFICE EQUIPMENT | 4,185,608 | 4,287,951 | 102.4 | 12.5 | 2.5 | 0 | 0 | 3,348,486 | 80.0 |
| 2123.2 | COMPANY COMM EQUIP | 1,719,023 | 1,586,731 | 92.3 | 10.2 | 4.6 | 0 | 0 | 943,744 | 54.9 |
| 2124 | GEN PURPOSE CMPTR | 68,171,220 | 65,345,000 | 95.9 | 8.7 | 1.7 | 6 | 5 | 52,219,155 | 76.6 |
| 2212 | DIGITAL SW EQUIP | 899,492,511 | 493,905,660 | 54.9 | 11.0 | 5.2 | 3 | 3 | 459,640,673 | 51.1 |
| 2220 | OPERATOR SYSTEMS | 1,962,173 | 100,607 | 5.1 | 12.0 | 3.8 | -3 | -3 | 1,381,370 | 70.4 |
| 2231 | RADIO SYSTEMS | 20,997,530 | 20,642,508 | 98.3 | 17.6 | 5.0 | -1 | -2 | 15,391,189 | 73.3 |
| 2232 | CIRCUIT EQUIP | | | | | | | | | |
| | CIRCUIT DDS | 3,516,888 | 3,171,205 | 90.2 | 10.4 | 3.4 | 8 | 3 | 2,352,798 | 66.9 |
| | CIRCUIT DIGITAL | 1,084,181,775 | 657,468,596 | 60.6 | 10.7 | 5.3 | 2 | 2 | 536,669,979 | 49.5 |
| | CIRCUIT ANALOG | 25,342,409 | 25,674,921 | 101.3 | 14.7 | 2.8 | -1 | 0 | 20,476,666 | 80.8 |
| 2362 | OTHER TERM EQUIP | 51,022,353 | 28,796,299 | 56.4 | 11.1 | 6.5 | 8 | 2 | 22,500,858 | 44.1 |
| 2411 | POLE LINES | 38,664,356 | 34,911,771 | 90.3 | 35.0 | 25.0 | -86 | -138 | 40,636,238 | 105.1 |
| 2421 | AERIAL CABLE MET | 145,481,570 | 152,605,742 | 104.9 | 14.5 | 5.0 | -21 | -27 | 124,095,779 | 85.3 |
| 2421 | AERIAL CABLE NON MET | 6,839,635 | 3,012,601 | 44.0 | 15.0 | 8.7 | -27 | -27 | 3,645,525 | 53.3 |
| 2422 | UNDGRD CABLE MET | 284,539,853 | 236,393,171 | 83.1 | 19.0 | 5.6 | -6 | -6 | 212,835,810 | 74.8 |
| 2422 | UNDGRD CABLE NON MET | 133,504,518 | 66,293,221 | 49.7 | 13.4 | 6.8 | -6 | -6 | 69,689,358 | 52.2 |
| 2423 | BURIED CABLE MET | 1,194,457,308 | 855,895,237 | 71.7 | 13.9 | 5.4 | -7 | -7 | 781,175,079 | 65.4 |
| 2423 | BURIED CABLE NON MET | 17,321,629 | 8,542,486 | 49.3 | 18.0 | 8.7 | -7 | -7 | 9,578,861 | 55.3 |
| 2424 | SUB CABLE MET | 1,887 | 2,294 | 121.6 | 22.0 | 0.5 | 0 | 0 | 1,844 | 97.7 |
| 2424 | SUB CABLE NON MET | 0 | 0 | 0.0 | 0.0 | 0.0 | 0 | 0 | 0 | 0.0 |
| 2426 | INTRA BLDG CA MET | 31,784,356 | 24,404,951 | 76.8 | 21.0 | 8.1 | 2 | 0 | 19,769,869 | 62.2 |
| 2426 | INTRA BLDG NON MET | 773,315 | 473,231 | 61.2 | 10.5 | 6.2 | 0 | 0 | 317,059 | 41.0 |
| 2431 | AERIAL WIRE | 8,068,659 | 7,303,094 | 90.5 | 11.2 | 5.3 | -25 | -30 | 5,712,611 | 70.8 |
| 2441 | CONDUIT SYSTEMS | 330,285,891 | 78,455,729 | 23.8 | 57.0 | 43.0 | -20 | -20 | 97,434,338 | 29.5 |
| | TOTAL | 4,600,342,426 | 2,857,461,209 | 62.1 | | | | | 2,577,072,261 | 56.0 |

DIGITAL SW RESERVE ADJ FOR RESIDUAL ANALOG SW, SXS, & XBR - UCB, BCB, NCB 1925 VINTAGE INVESTMENT EXCLUDED

/18/04
12:51 AM
XREF: 09
PRES: 1997,SF,02
PROP: 2004,SG,02
PRESCRIBED PARAMETERS

COMPANY: QWEST CORPORATION
STATE: ARIZONA
PAGE 1 OF 1

PARAMETER REPORT

PRESCRIBED

| CATEGORY | FIRST ELG YEAR | P.L. OR AYFR | AVG. NET SALV. | FUTURE NET SALV. | CURVE SHAPE PARAMETERS C | G | S | COMMENTS |
|---|---|---|---|---|---|---|---|---|
| 2112 MOTOR VEHICLES | | | 15 | 16 | | | | |
| 2112 PASSENGER CARS | 1983 | 8.6 | 15.4 | 16.0 | IOWA CURVE L3.0 | | | |
| 2112 LIGHT TRUCKS | 1983 | 8.6 | 15.4 | 16.0 | IOWA CURVE L3.0 | | | |
| 2112 HEAVY TRUCKS | 1983 | 8.6 | 15.4 | 16.0 | IOWA CURVE L3.0 | | | |
| 2114 SPEC PURPOSE VEHICLES | 0 | 16.1 | 0 | 0 | IOWA CURVE S6.0 | | | |
| 2115 GARAGE WORK EQUIP | 0 | 13.7 | -24 | -4 | IOWA CURVE L0.0 | | | |
| 2116 OTHER WORK EQUIP | 0 | 11.5 | 9 | 7 | IOWA CURVE L4.0 | | | |
| 2121 BUILDINGS | | | 2 | -6 | | | | |
| 2121 LARGE BUILDINGS | 1983 | 43.0 | 2.0 | -6.0 | IOWA CURVE R1.0 | | | |
| 2121 OTHER BUILDINGS | 1983 | 43.0 | 2.0 | -6.0 | IOWA CURVE R1.0 | | | |
| 2122 FURNITURE | 1983 | 9.5 | 3 | 0 | IOWA CURVE O4.0 | | | |
| 2123.1 OFFICE EQUIPMENT | 1983 | 7.0 | 0 | 0 | IOWA CURVE L0.5 | | | |
| 2123.2 COMPANY COMM EQUIP | | | 0 | 0 | | | | |
| 2123.2 STAND ALONE | 0 | 8.3 | -0.1 | 0.0 | IOWA CURVE L0.5 | | | |
| 2123.2 PBX & KEY INTRASYSTEMS | 0 | 8.3 | -0.1 | 0.0 | IOWA CURVE L0.5 | | | |
| 2124 GEN PURPOSE CMPTR | 1983 | 5.0 | 6 | 5 | IOWA CURVE O1.0 | | | |
| 2212 DIGITAL SW EQUIP | 1983 | 10.0 | 3 | 3 | IOWA CURVE O1.0 | | | |
| 2220 OPERATOR SYSTEMS | 1983 | 10.7 | -3 | -3 | IOWA CURVE S2.0 | | | |
| 31 RADIO SYSTEMS | 1983 | 15.1 | -1 | -2 | IOWA CURVE S1.5 | | | |
| 2232 CIRCUIT DDS | 1983 | 8.1 | 8 | 3 | IOWA CURVE L1.0 | | | |
| 2232 CIRCUIT DIGITAL | 1983 | 10.0 | 2 | 2 | IOWA CURVE O2.0 | | | |
| 2232 CIRCUIT ANALOG | 1983 | 8.0 | -1 | 0 | IOWA CURVE L0.0 | | | |
| 2362 OTHER TERM EQUIP | 0 | 6.8 | 8 | 2 | IOWA CURVE O3.0 | | | |
| 2411 POLE LINES | 1982 | 46.4 | -86 | -138 | IOWA CURVE O1.0 | | | |
| 2421 AERIAL CABLE MET | 1982 | 12.0 | -21 | -27 | IOWA CURVE R1.0 | | | |
| 2421 AERIAL CABLE NON MET | 1982 | 14.5 | -27 | -27 | IOWA CURVE SQ | | | |
| 2422 UNDGRD CABLE MET | 1982 | 15.0 | -6 | -6 | IOWA CURVE R1.5 | | | |
| 2422 UNDGRD CABLE NON MET | 1982 | 13.1 | -6 | -6 | IOWA CURVE SQ | | | |
| 2423 BURIED CABLE MET | 1982 | 12.0 | -7 | -7 | IOWA CURVE L1.5 | | | |
| 2423 BURIED CABLE NON MET | 1982 | 17.6 | -7 | -7 | IOWA CURVE SQ | | | |
| 2424 SUB CABLE MET | 1982 | 15.0 | 0 | 0 | IOWA CURVE SQ | | | |
| 2424 SUB CABLE NON MET | 1982 | 9.0 | 0 | 0 | IOWA CURVE SQ | | | |
| 2426 INTRA BLDG CA MET | 1982 | 19.0 | 2 | 0 | IOWA CURVE L2.0 | | | |
| 2426 INTRA BLDG CABLE NON MET | 1982 | 11.5 | 0 | 0 | IOWA CURVE O1.0 | | | |
| 2431 AERIAL WIRE | 0 | 8.9 | -25 | -30 | IOWA CURVE L0.0 | | | |
| 2441 CONDUIT SYSTEMS | 1982 | 56.6 | -20 | -20 | IOWA CURVE SQ | | | |

DIGITAL SW RESERVE ADJ FOR RESIDUAL ANALOG SW, SXS, & XBR - UCB, BCB, NCB 1925 VINTAGE INVESTMENT EXCLUDED

Arizona
T-01051B-03-0454
Dunkel 01-010

INTERVENOR: Dunkel and Associates

REQUEST NO: 010

a. Have the Qwest personnel or Qwest consultants prepared a Depreciation Study or Technical Update, (using either interstate or state depreciation rates) pertaining to or including the Qwest Arizona investments, using data which included data as of 12-31-2001, or later?

b. If the answer to part (a) is yes, list each such Depreciation Study or Technical Update, including the date of the most recent data used in the study.

c. For each Depreciation Study or Technical Update listed in response to part (b), state whether the data shown in that Study or Update included any fitting of curves (either Iowa curves or Gompertz- Makeham ) to mortality data (either full or computed).

RESPONSE:

(a) Yes. Qwest personnel prepared Technical Updates on a 12/31/02 and 12/31/03 basis. There have been no full Depreciation Studies prepared for Arizona during 12/31/01 to 12/31/03.

(b) The Technical Update as of 12/31/02 is filed as Exhibit 1 of the Direct Testimony of K. Dennis Wu. The 12/31/03 Technical Update statements are provided as Non-confidential Attachment "A". The 12/31/03 Technical Update does not include the vintage "retirement adjustment" referred to in Qwest's Response to Dunkel Set 1, Data Request No. 1.7. It does include adjustments to the digital switch account for residual reserve amounts from the accounts noted on the Technical Update statements (Non-confidential Attachment "A").

(c) There have been no curve fitting routines performed for either of the Technical Updates referred to in part (b). Qwest utilized Iowa curve shapes currently prescribed by the Arizona Corporation Commission.

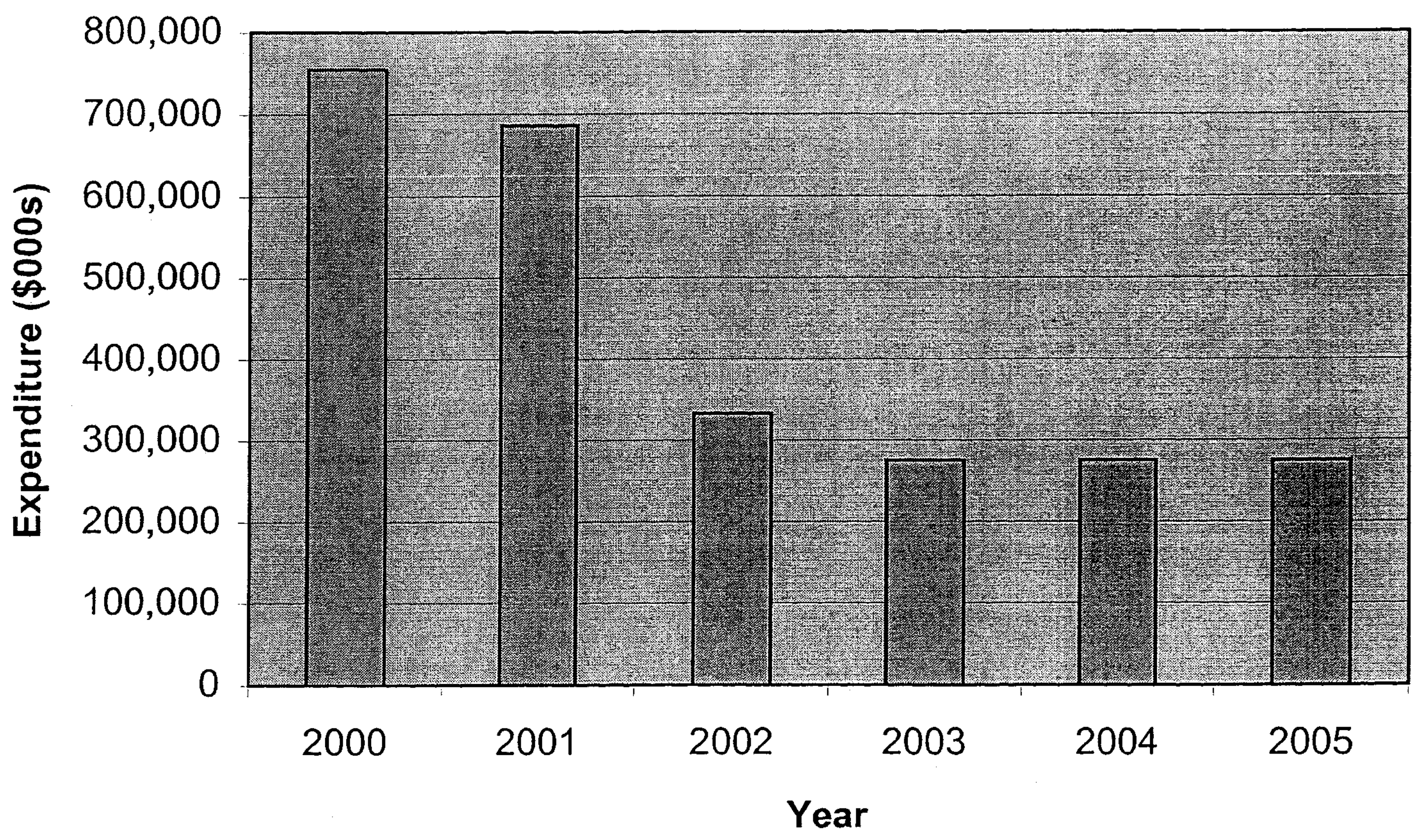
Respondent: *Jim Jones, Qwest Manager*

## Summary of Depreciation Adjustments
### Intrastate Basis
### ($000s)

| | Change from Qwest Filing in Annual Depreciation Accrual | Change from Qwest Filing in Net Rate Base (see note a) | Source |
|---|---|---|---|
| (1) Staff - Adjustment to End of Test Year Percent Reserve, Calculated on 12/31/03 Investments | -53,310 | -66,661 | WDA 02-005 and PFA-01 |
| (2) Staff - Adjustment to Update Projection Lives and Future Net Salvage Depreciaiton Parameters | -86,563 | 0 | Schedule WDA-12 and WDA 02-005 |
| (3) Overall Impact of Both Staff Adjustments | -139,873 | -66,661 | Row (1) + Row (2) |

Note:
a. Staff accounting witness will include any income tax impacts.

QWEST CONSTRUCTION EXPENDITURES IN ARIZONA



REDACTED



## QWEST CONSTRUCTION EXPENDITURES IN ARIZONA
## ($000)

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|
| Publicly Available Construction Expenditure Amount | 754,173 | 685,877 | 332,556 | 275,002 | 275,002 | 275,002 |
| Source | FCC ARMIS Report 43-02 Table B-6 | FCC ARMIS Report 43-02 Table B-6 | FCC ARMIS Report 43-02 Table B-6 | Schedule F-3 Qwest's R14 Filing | Schedule F-3 Qwest's R14 Filing | Schedule F-3 Qwest's R14 Filing |
| Confidentially Available Construction Expenditure Amount | | | | 275,002 | 275,002 | 275,002 |
| Source | Confidential Attachment A to Qwest's Response to RUCO 3-17 | Confidential file Entitled "Inputs_1203.xls" Provided by Qwest | Confidential file Entitled "Inputs_1203.xls" Provided by Qwest | Public Schedule F-3 Qwest's R14 Filing | Public Schedule F-3 Qwest's R14 Filing | Public Schedule F-3 Qwest's R14 Filing |

Arizona
T-01051B-03-0454
Dunkel 01-005

INTERVENOR: Dunkel and Associates

REQUEST NO: 005

For each depreciable account, provide the Gross Salvage and Cost of Removal data for the years 1983 through 2003. This should be information similar to that provided on "Table A, Annual Retirements, Gross Salvage and Cost of Removal" included in the Qwest Supplement to Application filed November 12, 1997 in the prior Depreciation Case (Docket No T-1051B-97-0689), excepted using the more current data (20 years through 2003). For each year the information should at include, but not necessarily limited to, the plant in service, the plant retired, the gross salvage, and the cost of removal. Provide in electronic format (in the same electronic format as this information is provided to the FCC) on an IBM compatible 3.5" disk or CD and in paper format.

RESPONSE:

See Non-confidential Attachments "A" and "B" for the requested information.

Respondent: Jim Jones, Qwest Manager

06/04/04
09:42 AM
XREF: 09
PRES: 1997,SF,02
PROP: 2004,SA,02

COMPANY: QWEST CORPORATION
STATE: ARIZONA
ACCOUNT: 2423 BURIED CABLE MET
CATEGORY: 2423 BURIED CABLE MET




TABLE A
ANNUAL RETIREMENTS
GROSS SALVAGE AND COST OF REMOVAL

TOTAL RETIREMENTS

| YEAR | PLANT IN SERVICE DEC. 31 | PLANT RETIRED* | GROSS SALVAGE* AMOUNT | GROSS SALVAGE* PERCENT | COST OF REMOVAL* AMOUNT | COST OF REMOVAL* PERCENT | NET SALVAGE PERCENT |
|---|---|---|---|---|---|---|---|
| | A | B | C | D=(C/B) *100 | E | F=(E/B) *100 | G=(D-F) |
| 1983 | 341,030,033 | 1,091,942 | 269,318 | 24.7 | 271,322 | 24.8 | -0.1 |
| 1984 | 453,054,876 | 2,952,967 | 252,694 | 8.6 | 359,699 | 12.2 | -3.6 |
| 1985 | 515,528,004 | 3,942,588 | 391,710 | 9.9 | 378,851 | 9.6 | 0.3 |
| 1986 | 568,349,007 | 3,828,198 | 505,262 | 13.2 | 268,159 | 7.0 | 6.2 |
| 1987 | 621,495,274 | 8,526,647 | 312,824 | 3.7 | 350,990 | 4.1 | -0.4 |
| 1988 | 661,399,112 | 5,205,021 | 335,453 | 6.4 | 475,687 | 9.1 | -2.7 |
| 1989 | 697,118,053 | 8,571,997 | 251,777 | 2.9 | 528,112 | 6.2 | -3.3 |
| 1990 | 726,997,349 | 7,912,039 | 232,275 | 2.9 | 630,559 | 8.0 | -5.1 |
| 1991 | 755,505,302 | 8,371,185 | 185,734 | 2.2 | 542,710 | 6.5 | -4.3 |
| 1992 | 789,491,483 | 3,725,800 | 125,320 | 3.4 | 526,421 | 14.1 | -10.7 |
| 1993 | 821,220,535 | 3,335,448 | 214,946 | 6.4 | 417,838 | 12.5 | -6.1 |
| 1994 | 862,860,571 | 4,482,470 | 274,889 | 6.1 | 462,087 | 10.3 | -4.2 |
| 1995 | 923,074,315 | 393,716 | 335,694 | 85.3 | 528,989 | 134.4 | -49.1 |
| 1996 | 1,010,068,793 | 6,564,761 | 417,460 | 6.4 | 686,101 | 10.5 | -4.1 |
| 1997 | 1,096,797,018 | 5,451,901 | 1,323,477 | 24.3 | 616,741 | 11.3 | 13.0 |
| 1998 | 1,161,283,610 | 5,630,145 | -656,088 | -11.7 | 822,731 | 14.6 | -26.3 |
| 1999 | 1,256,424,735 | 3,437,219 | 322,711 | 9.4 | 2,434,733 | 70.8 | -61.4 |
| 2000 | 1,358,187,361 | 45,598,074 | 332,533 | 0.7 | 18,271,820 | 40.1 | -39.4 |
| 2001 | 1,490,943,138 | 6,550,043 | 1,565,792 | 23.9 | 8,569,771 | 130.8 | -106.9 |
| 2002 | 1,603,313,910 | 5,974,011 | 276,720 | 4.6 | 1,813,299 | 30.4 | -25.8 |
| 2003 | 1,644,110,671 | 5,131,169 | 117,459 | 2.3 | 992,325 | 19.3 | -17.0 |
| GRAND TOTAL | | 146,677,341 | 7,387,960 | 5.0 | 39,948,945 | 27.2 | -22.2 |
| 1983-2003# | | 146,677,341 | 7,387,960 | 5.0 | 39,948,945 | 27.2 | -22.2 |
| 1994-2003## | | 89,213,509 | 4,310,647 | 4.8 | 35,198,597 | 39.5 | -34.7 |

\# REPRESENTS RETIREMENTS FROM SURVIVING VINTAGES.
\#\# BAND OF LAST 10 ACTIVITY YEARS.
* EXCLUDING SALES & TRANSACTIONS THAT WERE EXCLUDED FROM LIFE DETERMINATION.

## Qwest Assumed 44 Times More Retirement than Actually Occurred in Buried Cable Metallic Account

| | Amount | Source |
|---|---|---|
| Actual Amount Retired in 2003 | $5.1 million | Schedule WDA-5 |
| Assumed 2003 Retired Amount in Qwest Calculation | $228 million | Page 3 of this Schedule |
| **Qwest Calculation divided by Actual Retirement in 2003** | **44.7** | |

Company: Qwest - Arizona
Account: 2423 Buried Cable Metallic

Avg Life: 12.0
Iowa Curve: L1.5

## Retirement Amount Projected by Curve

| | Vintage | Age | 1/1/03 Amount Surviving | Percent Retired During Year based on Curve | Qwest Projected Retirement Amount in 2003 |
|---|---|---|---|---|---|
| | A | B | C | D | E = C*D |
| * | 2002 | 0.5 | 67,153,436 | 0.63% | 421,008 |
| * | 2001 | 1.5 | 104,985,190 | 1.30% | 1,366,650 |
| * | 2000 | 2.5 | 138,272,697 | 2.19% | 3,031,834 |
| * | 1999 | 3.5 | 103,905,174 | 3.23% | 3,359,513 |
| * | 1998 | 4.5 | 88,168,309 | 4.55% | 4,010,533 |
| * | 1997 | 5.5 | 94,242,748 | 6.16% | 5,803,124 |
| * | 1996 | 6.5 | 92,591,577 | 7.77% | 7,193,203 |
| * | 1995 | 7.5 | 70,944,467 | 9.20% | 6,527,601 |
| * | 1994 | 8.5 | 44,929,447 | 10.47% | 4,702,139 |
| * | 1993 | 9.5 | 33,970,174 | 11.54% | 3,919,454 |
| * | 1992 | 10.5 | 36,489,077 | 12.44% | 4,540,760 |
| * | 1991 | 11.5 | 35,183,412 | 13.24% | 4,657,605 |
| * | 1990 | 12.5 | 34,823,081 | 13.99% | 4,870,853 |
| * | 1989 | 13.5 | 41,594,703 | 14.77% | 6,143,982 |
| * | 1988 | 14.5 | 48,007,424 | 15.63% | 7,504,609 |
| * | 1987 | 15.5 | 58,944,952 | 16.62% | 9,793,973 |
| * | 1986 | 16.5 | 52,207,748 | 17.74% | 9,263,712 |
| * | 1985 | 17.5 | 60,864,325 | 19.00% | 11,561,467 |
| * | 1984 | 18.5 | 54,321,832 | 20.39% | 11,076,988 |
| * | 1983 | 19.5 | 38,943,562 | 21.91% | 8,532,715 |
| * | 1982 | 20.5 | 50,962,708 | 23.56% | 12,006,120 |
| | 1981 | 21.5 | 21,558,966 | 25.34% | 5,462,723 |
| | 1980 | 22.5 | 20,371,825 | 27.28% | 5,557,187 |
| | 1979 | 23.5 | 19,908,568 | 29.38% | 5,848,220 |
| | 1978 | 24.5 | 17,984,499 | 31.65% | 5,692,131 |
| | 1977 | 25.5 | 12,237,868 | 34.16% | 4,179,996 |
| | 1976 | 26.5 | 8,702,672 | 36.85% | 3,207,077 |
| | 1975 | 27.5 | 7,420,084 | 39.78% | 2,951,697 |
| | 1974 | 28.5 | 13,585,162 | 42.98% | 5,839,175 |
| | 1973 | 29.5 | 22,934,853 | 46.41% | 10,644,570 |
| | 1972 | 30.5 | 12,670,377 | 50.18% | 6,357,697 |
| | 1971 | 31.5 | 12,420,541 | 54.56% | 6,776,561 |
| | 1970 | 32.5 | 12,403,581 | 59.95% | 7,435,376 |

Company: Qwest - Arizona
Account: 2423 Buried Cable Metallic

Avg Life: 12.0
Iowa Curve L1.5

**Retirement Amount Projected by Curve**

| Vintage | Age | 1/1/03 Amount Surviving | Percent Retired During Year based on Curve | Qwest Projected Retirement Amount in 2003 |
|---|---|---|---|---|
| A | B | C | D | E = C*D |
| 1969 | 33.5 | 7,980,942 | 66.95% | 5,343,177 |
| 1968 | 34.5 | 4,191,031 | 75.67% | 3,171,309 |
| 1967 | 35.5 | 3,380,570 | 100.00% | 3,380,570 |
| 1966 | 36.5 | 3,423,840 | 100.00% | 3,423,840 |
| 1965 | 37.5 | 2,081,092 | 100.00% | 2,081,092 |
| 1964 | 38.5 | 2,782,549 | 100.00% | 2,782,549 |
| 1963 | 39.5 | 2,582,261 | 100.00% | 2,582,261 |
| 1962 | 40.5 | 1,499,420 | 100.00% | 1,499,420 |
| 1961 | 41.5 | 1,110,473 | 100.00% | 1,110,473 |
| 1960 | 42.5 | 859,272 | 100.00% | 859,272 |
| 1959 | 43.5 | 301,454 | 100.00% | 301,454 |
| 1958 | 44.5 | 195,393 | 100.00% | 195,393 |
| 1957 | 45.5 | 235,269 | 100.00% | 235,269 |
| 1956 | 46.5 | 462,193 | 100.00% | 462,193 |
| 1955 | 47.5 | 169,497 | 100.00% | 169,497 |
| 1954 | 48.5 | 270,590 | 100.00% | 270,590 |
| 1953 | 49.5 | 60,690 | 100.00% | 60,690 |
| 1952 | 50.5 | 91,618 | 100.00% | 91,618 |
| 1951 | 51.5 | 4,543 | 100.00% | 4,543 |
| 1950 | 52.5 | 2,476 | 100.00% | 2,476 |
| 1949 | 53.5 | 13,427 | 100.00% | 13,427 |
| 1948 | 54.5 | 3,193 | 100.00% | 3,193 |
| 1947 | 55.5 | 427 | 100.00% | 427 |
| 1946 | 56.5 | 1,455 | 100.00% | 1,455 |
| 1945 | 57.5 | 1,320 | 100.00% | 1,320 |
| 1944 | 58.5 | 0 | 100.00% | 0 |
| 1943 | 59.5 | 0 | 100.00% | 0 |
| 1942 | 60.5 | 364 | 100.00% | 364 |
| 1941 | 61.5 | 78,315 | 100.00% | 78,315 |
| 1940 | 62.5 | 2,371 | 100.00% | 2,371 |
| 1939 | 63.5 | 0 | 100.00% | 0 |
| 1938 | 64.5 | 1,640 | 100.00% | 1,640 |
| 1937 | 65.5 | 230 | 100.00% | 230 |
| 1936 | 66.5 | 5,024 | 100.00% | 5,024 |
| 1935 | 67.5 | 0 | 100.00% | 0 |
| 1934 | 68.5 | 0 | 100.00% | 0 |
| 1933 | 69.5 | 0 | 100.00% | 0 |
| 1932 | 70.5 | 0 | 100.00% | 0 |
| 1931 | 71.5 | 93 | 100.00% | 93 |
| 1930 | 72.5 | 2,314 | 100.00% | 2,314 |
| Total | | 1,565,500,385 | 14.59% | 228,378,109 |

Source:
Qwest Response to WDA 2-25

Arizona
T-01051B-03-0454 and T-00000D-00-0672
WDA 16-006

INTERVENOR: William W. Dunkel and Associates

REQUEST NO: 006

Regarding the "generation arrangement" as of 1/1/2003 for buried cable metallic (account 2423) provided by Qwest as part of "Attachment A" in response to WDA 02-025:

(a) For 1956, the "remaining life years" shown is "0.50". Is it correct that indicates that for purposes of this calculation, all the surviving investments on that line were calculated as retiring during the year 2003? If this is not a correct statement, provide the corrected statement, and the supporting calculations.

(b) The "projection life table" for buried cable metallic (account 2423) provided by Qwest as part of "Attachment A" in response to WDA 02-025 for the age "19.5" shows $2,508 retiring out of $11,444 (surviving at the start of the year). Is it correct that indicates that for purposes of this calculation, 21.9% of all the surviving investments which is age 19.5 (at the start of the year) is considered as retiring during the year 2003? If this is not a correct statement, provide the corrected statement, and the supporting calculations.

RESPONSE:

Objection. This request is not reasonably calculated to lead to the discovery of admissible evidence concerning issues related to the modification, renewal or termination of the Price Cap Plan. Therefore, this request is overly broad and unduly burdensome because it seeks information beyond the scope of this proceeding. Without waiving this objection, Qwest provides the following response:

(a) 0.50 represents the average remaining life in years for vintage 1956 investment as of 1/1/2003. "For the purposes of this calculation", the surviving vintage 1956 investment dollars are essentially retired during the year 2003.

(b) "For the purposes of this calculation", yes.

Respondent: Dennis Wu

Arizona
T-01051B-03-0454
WDA 02-025

INTERVENOR: William W. Dunkel and Associates

REQUEST NO: 025

Column E of Exhibit KDW-1 shows remaining life years. Provide the workpapers showing the calculation of each of the remaining life figures in that column.

RESPONSE:

Please see Non-Confidential Attachment A.

Respondent: Dennis Wu

ATTACHMENT "A"
AZ-DOC. NO. T-0151B-03-0454
WDA SET 2, NO.02 – 25

06/18/04
01:36 PM
XREF: 09
PRES: 1997,SF,02
PROP: 2003,SJ,02

COMPANY: QWEST CORPORATION
STATE: ARIZONA
ACCOUNT: 2423 BURIED CABLE MET
CATEGORY: 2423 BURIED CABLE MET
TABLE 1-VG/ELG

GENERATION ARRANGEMENT
DEVELOPMENT OF AVERAGE REMAINING LIFE AND AVERAGE SERVICE LIFE

| | | EXPERIENCE AS OF 1-1-2003% | | | REMAIN ING | VINT AVG | AVERAGE | REMAINING |
|---|---|---|---|---|---|---|---|---|
| VINT AGE | AGE | AMOUNT SURVIVING | PROP SURV | REAL LIFE | LIFE YEARS | LIFE YEARS | LIFE WEIGHTS | LIFE WEIGHTS |
| N | A | B | C | D | E++ | F+++ | G=B/F | H=E*G |
| *2002 | 0.5 | 67,153,436 | 0.9982 | 0.50 | 8.19 | 8.69 | 7,727,540 | 63,289,666 |
| *2001 | 1.5 | 104,985,190 | 0.9887 | 1.49 | 7.63 | 9.13 | 11,494,826 | 87,742,951 |
| *2000 | 2.5 | 138,272,697 | 0.9875 | 2.48 | 7.08 | 9.58 | 14,427,296 | 102,204,456 |
| *1999 | 3.5 | 103,905,174 | 0.9690 | 3.44 | 6.58 | 10.08 | 10,308,001 | 67,827,169 |
| *1998 | 4.5 | 88,168,309 | 0.9802 | 4.45 | 6.12 | 10.62 | 8,302,580 | 50,806,698 |
| *1997 | 5.5 | 94,242,748 | 0.9921 | 5.48 | 5.72 | 11.22 | 8,399,286 | 48,046,674 |
| *1996 | 6.5 | 92,591,577 | 0.9893 | 6.46 | 5.40 | 11.90 | 7,781,012 | 42,015,001 |
| *1995 | 7.5 | 70,994,467 | 0.9881 | 7.46 | 5.15 | 12.65 | 5,614,332 | 28,886,976 |
| *1994 | 8.5 | 44,929,447 | 0.9807 | 8.42 | 4.94 | 13.44 | 3,344,015 | 16,505,316 |
| *1993 | 9.5 | 33,970,174 | 0.9807 | 9.40 | 4.76 | 14.26 | 2,382,678 | 11,334,730 |
| *1992 | 10.5 | 36,489,077 | 0.9822 | 10.43 | 4.60 | 15.10 | 2,417,247 | 11,107,986 |
| *1991 | 11.5 | 35,183,412 | 0.9712 | 11.35 | 4.44 | 15.94 | 2,207,422 | 9,798,064 |
| *1990 | 12.5 | 34,823,081 | 0.9620 | 12.26 | 4.28 | 16.78 | 2,075,398 | 8,880,602 |
| *1989 | 13.5 | 41,594,703 | 0.9673 | 13.29 | 4.11 | 17.61 | 2,361,789 | 9,710,557 |
| *1988 | 14.5 | 48,007,424 | 0.9617 | 14.24 | 3.94 | 18.44 | 2,604,039 | 10,248,863 |
| *1987 | 15.5 | 58,944,952 | 0.9462 | 15.16 | 3.75 | 19.25 | 3,061,623 | 11,489,797 |
| *1986 | 16.5 | 52,207,748 | 0.9517 | 16.20 | 3.57 | 20.07 | 2,601,837 | 9,277,430 |
| *1985 | 17.5 | 60,864,325 | 0.4319 | 15.68 | 3.38 | 20.88 | 2,915,251 | 9,847,436 |
| *1984 | 18.5 | 54,321,832 | 0.9214 | 17.73 | 3.19 | 21.69 | 2,504,330 | 7,991,718 |
| *1983 | 19.5 | 38,943,562 | 0.9309 | 18.86 | 3.01 | 22.51 | 1,730,229 | 5,204,099 |
| *1982 | 20.5 | 50,962,708 | 0.9315 | 19.86 | 2.83 | 23.33 | 2,184,561 | 6,179,210 |
| 1981 | 21.5 | 21,558,966 | 0.9277 | 20.61 | 2.86 | 23.26 | 926,763 | 2,647,738 |
| 1980 | 22.5 | 20,371,825 | 0.9053 | 21.32 | 2.66 | 23.73 | 858,571 | 2,280,923 |
| 1979 | 23.5 | 19,908,568 | 0.9215 | 22.52 | 2.47 | 24.80 | 802,888 | 1,979,728 |
| 1978 | 24.5 | 17,984,499 | 0.9167 | 23.47 | 2.28 | 25.56 | 703,654 | 1,606,942 |
| 1977 | 25.5 | 12,237,868 | 0.8777 | 23.97 | 2.11 | 25.83 | 473,866 | 999,494 |
| 1976 | 26.5 | 8,702,672 | 0.8792 | 24.88 | 1.94 | 26.59 | 327,257 | 636,487 |
| 1975 | 27.5 | 7,420,084 | 0.7384 | 24.49 | 1.79 | 25.81 | 287,504 | 513,537 |
| 1974 | 28.5 | 13,585,162 | 0.7903 | 25.73 | 1.64 | 27.02 | 502,742 | 822,490 |
| 1973 | 29.5 | 22,934,853 | 0.7478 | 26.33 | 1.49 | 27.45 | 835,565 | 1,245,188 |
| 1972 | 30.5 | 12,670,377 | 0.6567 | 27.06 | 1.35 | 27.94 | 453,435 | 611,284 |
| 1971 | 31.5 | 12,420,541 | 0.6729 | 27.12 | 1.21 | 27.93 | 444,694 | 538,428 |
| 1970 | 32.5 | 12,403,581 | 0.6770 | 27.66 | 1.08 | 28.39 | 436,880 | 470,121 |
| 1969 | 33.5 | 7,980,942 | 0.5904 | 27.89 | 0.89 | 28.42 | 280,815 | 251,256 |
| 1968 | 34.5 | 4,191,031 | 0.6088 | 28.44 | 0.75 | 28.89 | 145,054 | 108,790 |
| 1967 | 35.5 | 3,380,570 | 0.6031 | 28.91 | 0.50 | 29.21 | 115,744 | 57,872 |
| 1966 | 36.5 | 3,423,840 | 0.6174 | 30.72 | 0.50 | 31.03 | 110,333 | 55,166 |
| 1965 | 37.5 | 2,081,092 | 0.6167 | 31.51 | 0.50 | 31.81 | 65,413 | 32,706 |
| 1964 | 38.5 | 2,782,549 | 0.6268 | 31.43 | 0.50 | 31.74 | 87,664 | 43,832 |
| 1963 | 39.5 | 2,582,261 | 0.5897 | 32.15 | 0.50 | 32.45 | 79,581 | 39,790 |
| 1962 | 40.5 | 1,499,420 | 0.5805 | 32.96 | 0.50 | 33.25 | 45,093 | 22,547 |
| 1961 | 41.5 | 1,110,473 | 0.4754 | 32.69 | 0.50 | 32.92 | 33,729 | 16,864 |
| 1960 | 42.5 | 859,272 | 0.3778 | 29.86 | 0.50 | 30.05 | 28,595 | 14,298 |
| 1959 | 43.5 | 301,454 | 0.4089 | 31.16 | 0.50 | 31.37 | 9,611 | 4,805 |
| 1958 | 44.5 | 195,393 | 0.2838 | 29.43 | 0.50 | 29.58 | 6,606 | 3,303 |
| 1957 | 45.5 | 235,269 | 0.2103 | 26.55 | 0.50 | 26.65 | 8,827 | 4,414 |
| 1956 | 46.5 | 462,193 | 0.2050 | 25.92 | 0.50 | 26.02 | 17,764 | 8,882 |
| 1955 | 47.5 | 169,497 | 0.1687 | 25.20 | 0.50 | 25.28 | 6,705 | 3,352 |
| 1954 | 48.5 | 270,590 | 0.1526 | 29.42 | 0.50 | 29.50 | 9,173 | 4,586 |
| 1953 | 49.5 | 60,690 | 0.0769 | 26.76 | 0.50 | 26.80 | 2,265 | 1,132 |
| 1952 | 50.5 | 91,618 | 0.2333 | 32.71 | 0.50 | 32.83 | 2,791 | 1,395 |
| 1951 | 51.5 | 4,543 | 0.0410 | 26.48 | 0.50 | 26.50 | 171 | 86 |

06/18/04
01:36 PM
XREF: 09
PRES: 1997,SF,02
PROP: 2003,SJ,02

COMPANY: QWEST CORPORATION
STATE: ARIZONA
ACCOUNT: 2423 BURIED CABLE MET
CATEGORY: 2423 BURIED CABLE MET
TABLE 1-VG/ELG

GENERATION ARRANGEMENT
DEVELOPMENT OF AVERAGE REMAINING LIFE AND AVERAGE SERVICE LIFE

| VINT AGE | AGE | EXPERIENCE AS OF 1-1-2003% AMOUNT SURVIVING | PROP SURV | REAL LIFE | REMAINING LIFE YEARS | VINT AVG LIFE YEARS | AVERAGE LIFE WEIGHTS | REMAINING LIFE WEIGHTS |
|---|---|---|---|---|---|---|---|---|
| N | A | B | C | D | E++ | F+++ | G=B/F | H=E*G |
| 1950 | 52.5 | 2,476 | 0.0124 | 23.88 | 0.50 | 23.89 | 104 | 52 |
| 1949 | 53.5 | 13,427 | 0.0847 | 23.97 | 0.50 | 24.01 | 559 | 280 |
| 1948 | 54.5 | 3,193 | 0.2004 | 28.43 | 0.50 | 28.53 | 112 | 56 |
| 1947 | 55.5 | 427 | 0.0044 | 35.49 | 0.50 | 35.49 | 12 | 6 |
| 1946 | 56.5 | 1,455 | 0.0988 | 36.23 | 0.50 | 36.28 | 40 | 20 |
| 1945 | 57.5 | 1,320 | 0.1437 | 36.59 | 0.50 | 36.66 | 36 | 18 |
| 1944 | 58.5 | 0 | 0.0000 | 0.00 | | | | |
| 1943 | 59.5 | 0 | 0.0000 | 0.00 | | | | |
| 1942 | 60.5 | 364 | 0.1661 | 36.77 | 0.50 | 36.86 | 10 | 5 |
| 1941 | 61.5 | 78,315 | 0.1852 | 36.95 | 0.50 | 37.04 | 2,114 | 1,057 |
| 1940 | 62.5 | 2,371 | 0.0682 | 32.25 | 0.50 | 32.29 | 73 | 37 |
| 1939 | 63.5 | 0 | 0.0000 | 0.00 | | | | |
| 1938 | 64.5 | 1,640 | 0.2709 | 36.42 | 0.50 | 36.56 | 45 | 22 |
| 1937 | 65.5 | 230 | 0.0041 | 28.74 | 0.50 | 28.74 | 8 | 4 |
| 1936 | 66.5 | 5,024 | 0.0240 | 32.29 | 0.50 | 32.30 | 156 | 78 |
| 1935 | 67.5 | 0 | 0.0000 | 0.00 | | | | |
| 1934 | 68.5 | 0 | 0.0000 | 0.00 | | | | |
| 1933 | 69.5 | 0 | 0.0000 | 0.00 | | | | |
| 1932 | 70.5 | 0 | 0.0000 | 0.00 | | | | |
| 1931 | 71.5 | 93 | 0.0851 | 26.76 | 0.50 | 26.80 | 3 | 2 |
| 1930 | 72.5 | 2,314 | 0.1157 | 23.98 | 0.50 | 24.04 | 96 | 48 |
| TOTAL | | 1,565,550,385 | | | | | 114,558,413 | 633,424,521 |
| NON-ELG V | | 213,994,342 | | | | | 8,113,120 | 15,029,122 |
| ELG V | | 1,351,556,043 | | | | | 106,445,293 | 618,395,399 |

AVG SERVICE LIFE: ALL VINTS NELG VINTS ELG VINTS
TOT B/TOT G 13.66596 26.37633 12.69719
AVG REMAINING LIFE: ALL VINTS NELG VINTS ELG VINTS
TOT H/TOT G 5.52927 1.85245 5.80951
COMPUTED GROSS ADDS-ALL VINTS: AVG PROPORTION SURVIVING:
SUM OF (B/C) 1,753,449,939 B/ SUM OF (B/C) 0.89284

USING IOWA CURVE: L1.5
* ELG VINTAGES, PROJECTION LIFE 12.0
++ FROM TABLE 2-VG/ELG; COL H FOR ELG, COL I FOR VG
+++ FROM TABLE 2-VG/ELG FOR ELG VINTAGES, COMPUTED AS D+(C*E) FOR VG VINTAGES
% ACTUAL

ATTACHMENT "A"
AZ-DOC. NO. T-0151B-03-0454
WDA SET 2, NO.02 – 25



06/18/04
01:36 PM
XREF: 09
PRES: 1997,SF,02
PROP: 2003,SJ,02

COMPANY: QWEST CORPORATION
STATE: ARIZONA
ACCOUNT: 2423 BURIED CABLE MET
CATEGORY: 2423 BURIED CABLE MET
TABLE 1-VG/ELG

GENERATION ARRANGEMENT
DEVELOPMENT OF AVERAGE REMAINING LIFE AND AVERAGE SERVICE LIFE

| | | EXPERIENCE AS OF 1-1-2003% | | | REMAIN ING | VINT AVG | | |
|---|---|---|---|---|---|---|---|---|
| VINT AGE | AGE | AMOUNT SURVIVING | PROP SURV | REAL LIFE | LIFE YEARS | LIFE YEARS | AVERAGE LIFE WEIGHTS | REMAINING LIFE WEIGHTS |
| N | A | B | C | D | E++ | F+++ | G=B/F | H=E*G |
| *2002 | 0.5 | 67,153,436 | 0.9982 | 0.50 | 8.19 | 8.69 | 7,727,540 | 63,289,666 |
| *2001 | 1.5 | 104,985,190 | 0.9887 | 1.49 | 7.63 | 9.13 | 11,494,826 | 87,742,951 |
| *2000 | 2.5 | 138,272,697 | 0.9875 | 2.48 | 7.08 | 9.58 | 14,427,296 | 102,204,456 |
| *1999 | 3.5 | 103,905,174 | 0.9690 | 3.44 | 6.58 | 10.08 | 10,308,001 | 67,827,169 |
| *1998 | 4.5 | 88,168,309 | 0.9802 | 4.45 | 6.12 | 10.62 | 8,302,580 | 50,806,698 |
| *1997 | 5.5 | 94,242,748 | 0.9921 | 5.48 | 5.72 | 11.22 | 8,399,286 | 48,046,674 |
| *1996 | 6.5 | 92,591,577 | 0.9893 | 6.46 | 5.40 | 11.90 | 7,781,012 | 42,015,001 |
| *1995 | 7.5 | 70,994,467 | 0.9881 | 7.46 | 5.15 | 12.65 | 5,614,332 | 28,886,976 |
| *1994 | 8.5 | 44,929,447 | 0.9807 | 8.42 | 4.94 | 13.44 | 3,344,015 | 16,505,316 |
| *1993 | 9.5 | 33,970,174 | 0.9807 | 9.40 | 4.76 | 14.26 | 2,382,678 | 11,334,730 |
| *1992 | 10.5 | 36,489,077 | 0.9822 | 10.43 | 4.60 | 15.10 | 2,417,247 | 11,107,986 |
| *1991 | 11.5 | 35,183,412 | 0.9712 | 11.35 | 4.44 | 15.94 | 2,207,422 | 9,798,064 |
| *1990 | 12.5 | 34,823,081 | 0.9620 | 12.26 | 4.28 | 16.78 | 2,075,398 | 8,880,602 |
| *1989 | 13.5 | 41,594,703 | 0.9673 | 13.29 | 4.11 | 17.61 | 2,361,789 | 9,710,557 |
| *1988 | 14.5 | 48,007,424 | 0.9617 | 14.24 | 3.94 | 18.44 | 2,604,039 | 10,248,863 |
| *1987 | 15.5 | 58,944,952 | 0.9462 | 15.16 | 3.75 | 19.25 | 3,061,623 | 11,489,797 |
| *1986 | 16.5 | 52,207,748 | 0.9517 | 16.20 | 3.57 | 20.07 | 2,601,837 | 9,277,430 |
| *1985 | 17.5 | 60,864,325 | 0.4319 | 15.68 | 3.38 | 20.88 | 2,915,251 | 9,847,436 |
| *1984 | 18.5 | 54,321,832 | 0.9214 | 17.73 | 3.19 | 21.69 | 2,504,330 | 7,991,718 |
| *1983 | 19.5 | 38,943,562 | 0.9309 | 18.86 | 3.01 | 22.51 | 1,730,229 | 5,204,099 |
| *1982 | 20.5 | 50,962,708 | 0.9315 | 19.86 | 2.83 | 23.33 | 2,184,561 | 6,179,210 |
| 1981 | 21.5 | 21,558,966 | 0.9277 | 20.61 | 2.86 | 23.26 | 926,763 | 2,647,738 |
| 1980 | 22.5 | 20,371,825 | 0.9053 | 21.32 | 2.66 | 23.73 | 858,571 | 2,280,923 |
| 1979 | 23.5 | 19,908,568 | 0.9215 | 22.52 | 2.47 | 24.80 | 802,888 | 1,979,728 |
| 1978 | 24.5 | 17,984,499 | 0.9167 | 23.47 | 2.28 | 25.56 | 703,654 | 1,606,942 |
| 1977 | 25.5 | 12,237,868 | 0.8777 | 23.97 | 2.11 | 25.83 | 473,866 | 999,494 |
| 1976 | 26.5 | 8,702,672 | 0.8792 | 24.88 | 1.94 | 26.59 | 327,257 | 636,487 |
| 1975 | 27.5 | 7,420,084 | 0.7384 | 24.49 | 1.79 | 25.81 | 287,504 | 513,537 |
| 1974 | 28.5 | 13,585,162 | 0.7903 | 25.73 | 1.64 | 27.02 | 502,742 | 822,490 |
| 1973 | 29.5 | 22,934,853 | 0.7478 | 26.33 | 1.49 | 27.45 | 835,565 | 1,245,188 |
| 1972 | 30.5 | 12,670,377 | 0.6567 | 27.06 | 1.35 | 27.94 | 453,435 | 611,284 |
| 1971 | 31.5 | 12,420,541 | 0.6729 | 27.12 | 1.21 | 27.93 | 444,694 | 538,428 |
| 1970 | 32.5 | 12,403,581 | 0.6770 | 27.66 | 1.08 | 28.39 | 436,880 | 470,121 |
| 1969 | 33.5 | 7,980,942 | 0.5904 | 27.89 | 0.89 | 28.42 | 280,815 | 251,256 |
| 1968 | 34.5 | 4,191,031 | 0.6088 | 28.44 | 0.75 | 28.89 | 145,054 | 108,790 |
| 1967 | 35.5 | 3,380,570 | 0.6031 | 28.91 | 0.50 | 29.21 | 115,744 | 57,872 |
| 1966 | 36.5 | 3,423,840 | 0.6174 | 30.72 | 0.50 | 31.03 | 110,333 | 55,166 |
| 1965 | 37.5 | 2,081,092 | 0.6167 | 31.51 | 0.50 | 31.81 | 65,413 | 32,706 |
| 1964 | 38.5 | 2,782,549 | 0.6268 | 31.43 | 0.50 | 31.74 | 87,664 | 43,832 |
| 1963 | 39.5 | 2,582,261 | 0.5897 | 32.15 | 0.50 | 32.45 | 79,581 | 39,790 |
| 1962 | 40.5 | 1,499,420 | 0.5805 | 32.96 | 0.50 | 33.25 | 45,093 | 22,547 |
| 1961 | 41.5 | 1,110,473 | 0.4754 | 32.69 | 0.50 | 32.92 | 33,729 | 16,864 |
| 1960 | 42.5 | 859,272 | 0.3778 | 29.86 | 0.50 | 30.05 | 28,595 | 14,298 |
| 1959 | 43.5 | 301,454 | 0.4089 | 31.16 | 0.50 | 31.37 | 9,611 | 4,805 |
| 1958 | 44.5 | 195,393 | 0.2838 | 29.43 | 0.50 | 29.58 | 6,606 | 3,303 |
| 1957 | 45.5 | 235,269 | 0.2103 | 26.55 | 0.50 | 26.65 | 8,827 | 4,414 |
| 1956 | 46.5 | 462,193 | 0.2050 | 25.92 | 0.50 | 26.02 | 17,764 | 8,882 |
| 1955 | 47.5 | 169,497 | 0.1687 | 25.20 | 0.50 | 25.28 | 6,705 | 3,352 |
| 1954 | 48.5 | 270,590 | 0.1526 | 29.42 | 0.50 | 29.50 | 9,173 | 4,586 |
| 1953 | 49.5 | 60,690 | 0.0769 | 26.76 | 0.50 | 26.80 | 2,265 | 1,132 |
| 1952 | 50.5 | 91,618 | 0.2333 | 32.71 | 0.50 | 32.83 | 2,791 | 1,395 |
| 1951 | 51.5 | 4,543 | 0.0410 | 26.48 | 0.50 | 26.50 | 171 | 86 |

ATTACHMENT "A"
AZ-DOC. NO. T-0151B-03-0454
WDA SET 2, NO.02 – 25

06/18/04
01:36 PM
XREF: 09
PRES: 1997,SF,02
PROP: 2003,SJ,02

COMPANY: QWEST CORPORATION
STATE: ARIZONA
ACCOUNT: 2423 BURIED CABLE MET
CATEGORY: 2423 BURIED CABLE MET
TABLE 1-VG/ELG

GENERATION ARRANGEMENT
DEVELOPMENT OF AVERAGE REMAINING LIFE AND AVERAGE SERVICE LIFE

| VINT AGE | AGE | EXPERIENCE AS OF 1-1-2003% AMOUNT SURVIVING | PROP SURV | REAL LIFE | REMAINING LIFE YEARS | VINT AVG LIFE YEARS | AVERAGE LIFE WEIGHTS | REMAINING LIFE WEIGHTS |
|---|---|---|---|---|---|---|---|---|
| N | A | B | C | D | E++ | F+++ | G=B/F | H=E*G |
| 1950 | 52.5 | 2,476 | 0.0124 | 23.88 | 0.50 | 23.89 | 104 | 52 |
| 1949 | 53.5 | 13,427 | 0.0847 | 23.97 | 0.50 | 24.01 | 559 | 280 |
| 1948 | 54.5 | 3,193 | 0.2004 | 28.43 | 0.50 | 28.53 | 112 | 56 |
| 1947 | 55.5 | 427 | 0.0044 | 35.49 | 0.50 | 35.49 | 12 | 6 |
| 1946 | 56.5 | 1,455 | 0.0988 | 36.23 | 0.50 | 36.28 | 40 | 20 |
| 1945 | 57.5 | 1,320 | 0.1437 | 36.59 | 0.50 | 36.66 | 36 | 18 |
| 1944 | 58.5 | 0 | 0.0000 | 0.00 | | | | |
| 1943 | 59.5 | 0 | 0.0000 | 0.00 | | | | |
| 1942 | 60.5 | 364 | 0.1661 | 36.77 | 0.50 | 36.86 | 10 | 5 |
| 1941 | 61.5 | 78,315 | 0.1852 | 36.95 | 0.50 | 37.04 | 2,114 | 1,057 |
| 1940 | 62.5 | 2,371 | 0.0682 | 32.25 | 0.50 | 32.29 | 73 | 37 |
| 1939 | 63.5 | 0 | 0.0000 | 0.00 | | | | |
| 1938 | 64.5 | 1,640 | 0.2709 | 36.42 | 0.50 | 36.56 | 45 | 22 |
| 1937 | 65.5 | 230 | 0.0041 | 28.74 | 0.50 | 28.74 | 8 | 4 |
| 1936 | 66.5 | 5,024 | 0.0240 | 32.29 | 0.50 | 32.30 | 156 | 78 |
| 1935 | 67.5 | 0 | 0.0000 | 0.00 | | | | |
| 1934 | 68.5 | 0 | 0.0000 | 0.00 | | | | |
| 1933 | 69.5 | 0 | 0.0000 | 0.00 | | | | |
| 1932 | 70.5 | 0 | 0.0000 | 0.00 | | | | |
| 1931 | 71.5 | 93 | 0.0851 | 26.76 | 0.50 | 26.80 | 3 | 2 |
| 1930 | 72.5 | 2,314 | 0.1157 | 23.98 | 0.50 | 24.04 | 96 | 48 |
| TOTAL | | 1,565,550,385 | | | | | 114,558,413 | 633,424,521 |
| NON-ELG V | | 213,994,342 | | | | | 8,113,120 | 15,029,122 |
| ELG V | | 1,351,556,043 | | | | | 106,445,293 | 618,395,399 |

| | ALL VINTS | NELG VINTS | ELG VINTS |
|---|---|---|---|
| AVG SERVICE LIFE: TOT B/TOT G | 13.66596 | 26.37633 | 12.69719 |
| AVG REMAINING LIFE: TOT H/TOT G | 5.52927 | 1.85245 | 5.80951 |

COMPUTED GROSS ADDS-ALL VINTS: SUM OF (B/C) 1,753,449,939
AVG PROPORTION SURVIVING: B/ SUM OF (B/C) 0.89284

USING IOWA CURVE: L1.5
* ELG VINTAGES, PROJECTION LIFE 12.0
++ FROM TABLE 2-VG/ELG; COL H FOR ELG, COL I FOR VG
+++ FROM TABLE 2-VG/ELG FOR ELG VINTAGES, COMPUTED AS D+(C*E) FOR VG VINTAGES
% ACTUAL

ATTACHMENT "A"
AZ-DOC. NO. T-0151B-03-0454
WDA SET 2, NO.02 - 25

06/18/04
01:36 PM
XREF: 09
PRES: 1997,SF,02
PROP: 2003,SJ,02

COMPANY: QWEST CORPORATION
STATE: ARIZONA
ACCOUNT: 2423 BURIED CABLE MET
CATEGORY: 2423 BURIED CABLE MET
TABLE 2-VG/ELG

PROJECTION LIFE TABLE
AVERAGE SERVICE LIFE AND REMAINING LIFE BY AGE

PROJECTION LIFE TABLE PARAMETERS AVG LIFE 12.00

USING IOWA CURVE: L1.5

| BEGINNING OF YEAR AGE | BEGINNING OF YEAR AMOUNT IN SERVICE | AMOUNT RETIRED DURING YEAR (LIFE GROUP) | AGE OF AMOUNT RETIRED | ANNUAL ACCRUALS FOR BOY AGE A: EACH LIFE GROUP | ANNUAL ACCRUALS FOR BOY AGE A: FOR ALL REMAINING GROUPS | ELG AVG. SER VICE LIFE | ELG AVG. REMAIN ING LIFE | VG VINT REMAIN. LIFE |
|---|---|---|---|---|---|---|---|---|
| A | B | C=B-next B | D | E=C/D | F* | G=B/F | H=G-A | I# |
| 0.0 | 100,000 | 149 | 0.5 | 298 | 11,788 | 8.48 | 8.48 | 12.00 |
| 0.5 | 99,851 | 626 | 1.0 | 626 | 11,490 | 8.69 | 8.19 | 11.52 |
| 1.5 | 99,225 | 1,292 | 2.0 | 646 | 10,864 | 9.13 | 7.63 | 10.59 |
| 2.5 | 97,933 | 2,147 | 3.0 | 716 | 10,218 | 9.58 | 7.08 | 9.72 |
| 3.5 | 95,786 | 3,097 | 4.0 | 774 | 9,503 | 10.08 | 6.58 | 8.93 |
| 4.5 | 92,689 | 4,216 | 5.0 | 843 | 8,728 | 10.62 | 6.12 | 8.21 |
| 5.5 | 88,473 | 5,448 | 6.0 | 908 | 7,885 | 11.22 | 5.72 | 7.58 |
| 6.5 | 83,025 | 6,450 | 7.0 | 921 | 6,977 | 11.90 | 5.40 | 7.04 |
| 7.5 | 76,575 | 7,046 | 8.0 | 881 | 6,056 | 12.65 | 5.15 | 6.59 |
| 8.5 | 69,529 | 7,277 | 9.0 | 809 | 5,175 | 13.44 | 4.94 | 6.21 |
| 9.5 | 62,253 | 7,183 | 10.0 | 718 | 4,366 | 14.26 | 4.76 | 5.88 |
| 10.5 | 55,070 | 6,853 | 11.0 | 623 | 3,648 | 15.10 | 4.60 | 5.58 |
| 11.5 | 48,217 | 6,383 | 12.0 | 532 | 3,025 | 15.94 | 4.44 | 5.30 |
| 12.5 | 41,834 | 5,852 | 13.0 | 450 | 2,493 | 16.78 | 4.28 | 5.03 |
| 13.5 | 35,982 | 5,315 | 14.0 | 380 | 2,043 | 17.61 | 4.11 | 4.77 |
| 14.5 | 30,668 | 4,794 | 15.0 | 320 | 1,663 | 18.44 | 3.94 | 4.51 |
| 15.5 | 25,874 | 4,299 | 16.0 | 269 | 1,344 | 19.25 | 3.75 | 4.25 |
| 16.5 | 21,574 | 3,828 | 17.0 | 225 | 1,075 | 20.07 | 3.57 | 4.00 |
| 17.5 | 17,746 | 3,371 | 18.0 | 187 | 850 | 20.88 | 3.38 | 3.75 |
| 18.5 | 14,375 | 2,931 | 19.0 | 154 | 663 | 21.69 | 3.19 | 3.51 |
| 19.5 | 11,444 | 2,508 | 20.0 | 125 | 508 | 22.51 | 3.01 | 3.28 |
| 20.5 | 8,936 | 2,105 | 21.0 | 100 | 383 | 23.33 | 2.83 | 3.07 |
| 21.5 | 6,831 | 1,731 | 22.0 | 79 | 283 | 24.15 | 2.65 | 2.86 |
| 22.5 | 5,100 | 1,392 | 23.0 | 61 | 204 | 24.98 | 2.48 | 2.66 |
| 23.5 | 3,709 | 1,090 | 24.0 | 45 | 144 | 25.82 | 2.32 | 2.47 |
| 24.5 | 2,619 | 829 | 25.0 | 33 | 98 | 26.66 | 2.16 | 2.28 |
| 25.5 | 1,790 | 612 | 26.0 | 24 | 65 | 27.51 | 2.01 | 2.11 |
| 26.5 | 1,178 | 434 | 27.0 | 16 | 42 | 28.36 | 1.86 | 1.94 |
| 27.5 | 745 | 296 | 28.0 | 11 | 25 | 29.22 | 1.72 | 1.79 |
| 28.5 | 448 | 193 | 29.0 | 7 | 15 | 30.08 | 1.58 | 1.64 |
| 29.5 | 256 | 119 | 30.0 | 4 | 8 | 30.94 | 1.44 | 1.49 |
| 30.5 | 137 | 69 | 31.0 | 2 | 4 | 31.81 | 1.31 | 1.35 |
| 31.5 | 68 | 37 | 32.0 | 1 | 2 | 32.68 | 1.18 | 1.21 |
| 32.5 | 31 | 18 | 33.0 | 1 | 1 | 33.56 | 1.06 | 1.08 |
| 33.5 | 13 | 9 | 34.0 | 0 | 0 | 34.38 | 0.88 | 0.89 |

ATTACHMENT "A"
AZ-DOC. NO. T-0151B-03-0454
WDA SET 2, NO.02 - 25

06/18/04
01:36 PM
XREF: 09
PRES: 1997,SF,02
PROP: 2003,SJ,02

COMPANY: QWEST CORPORATION
STATE: ARIZONA
ACCOUNT: 2423 BURIED CABLE MET
CATEGORY: 2423 BURIED CABLE MET
TABLE 2-VG/ELG

PROJECTION LIFE TABLE
AVERAGE SERVICE LIFE AND REMAINING LIFE BY AGE

PROJECTION LIFE TABLE PARAMETERS AVG LIFE 12.00

USING IOWA CURVE: L1.5

| BEGINNING OF YEAR AGE | BEGINNING OF YEAR AMOUNT IN SERVICE | AMOUNT RETIRED DURING YEAR (LIFE GROUP) | AGE OF AMOUNT RETIRED | ANNUAL ACCRUALS FOR BOY AGE A EACH LIFE GROUP | ANNUAL ACCRUALS FOR BOY AGE A FOR ALL REMAINING GROUPS | ELG AVG. SER VICE LIFE | ELG AVG. REMAIN ING LIFE | VG VINT REMAIN. LIFE |
|---|---|---|---|---|---|---|---|---|
| A | B | C=B-next B | D | E=C/D | F* | G=B/F | H=G-A | I# |
| 34.5 | 4 | 3 | 35.0 | 0 | 0 | 35.24 | 0.74 | 0.75 |
| 35.5 | 1 | 1 | 36.0 | 0 | 0 | 36.00 | 0.50 | 0.50 |
| TOTAL | | 100,000 | | | | | | |

* F(AGE A) = SUM OF COL E AGE A TO END
\# I = 0.5 + ((SUM OF COL B FROM AGE A+1 THROUGH END)/(COL B AT AGE A))

Arizona
T-01051B-03-0454
Dunkel 01-001S2

INTERVENOR: Dunkel and Associates

REQUEST NO: 001S2

Please provide each of the following on a state basis for each depreciable account:

a. Separately for each depreciable account please provide the complete Generations Arrangements, using data through December 31, 2003. In addition to the paper copy, please also provide this requested information in electronic format (in the same electronic format as depreciation information is provided to the FCC) on an IBM compatible 3.5" disk or CD. (Note, page 2 of Qwest Exhibit NHH-2 indicates the Generation Arrangements with cost data as of December 31, 2003 exist.) In the electronic copy, the information for earlier years should not all be combined, if the separate vintage information is available (for example-not "1971 and prior years").

b. The Generation Arrangements provided should include all information normally included, similar to (but with data through 12-31-2003) the Generation Arrangements included in the Qwest Supplement to Application filed November 12, 1997 in the prior Depreciation Case (Docket No T-1051B-97-0689). The data should include, but is not necessarily limited to, the "Amount Surviving", the "Proportion Surviving", and the "Realized Life" for each vintage.

c. The dividing point between the vintages treated as ELG (Equal Life Group) and those treated as VG (Vintage Group) should be the same dividing point as it is for that account in the Generation Arrangement used in the Commission approved calculations of depreciation in the prior Depreciation Case (Docket No T-1051B-97-0689). (For example in the Buried Cable Metallic account, VG for the year 1981 and prior, but ELG for the year 1982 and after.)

RESPONSE:

a. See Non-confidential Attachments "A" and "B" for the requested information;

b. See also Non-confidential Attachments "A" and "B" for the requested information;

c. See also Non-confidential Attachments "A" and "B" for the requested information;

Respondent: Jim Jones, Qwest Manager

06/04/04
09:03 AM
XREF: 09
PRES: 1997,SF,02
PROP: 2004,SA,02

COMPANY: QWEST CORPORATION
STATE: ARIZONA
ACCOUNT: 2423 BURIED CABLE MET
CATEGORY: 2423 BURIED CABLE MET
TABLE 1-VG/ELG

GENERATION ARRANGEMENT
DEVELOPMENT OF AVERAGE REMAINING LIFE AND AVERAGE SERVICE LIFE

| VINT AGE | AGE | EXPERIENCE AS OF 1-1-2004& AMOUNT SURVIVING | PROP SURV | REAL LIFE | REMAINING LIFE YEARS | VINT AVG LIFE YEARS | AVERAGE LIFE WEIGHTS | REMAINING LIFE WEIGHTS |
|---|---|---|---|---|---|---|---|---|
| N | A | B | C | D | E++ | F+++ | G=B/F | H=E*G |
| *2003 | 0.5 | 63,550,598 | 0.9997 | 0.50 | 8.19 | 8.69 | 7,312,951 | 59,894,123 |
| *2002 | 1.5 | 68,916,847 | 0.9879 | 1.49 | 7.63 | 9.13 | 7,545,704 | 57,598,291 |
| *2001 | 2.5 | 119,473,541 | 0.9849 | 2.47 | 7.08 | 9.58 | 12,465,803 | 88,309,034 |
| *2000 | 3.5 | 141,529,013 | 0.9832 | 3.47 | 6.58 | 10.08 | 14,040,506 | 92,387,240 |
| *1999 | 4.5 | 102,216,637 | 0.9634 | 4.41 | 6.12 | 10.62 | 9,625,475 | 58,902,001 |
| *1998 | 5.5 | 86,892,236 | 0.9781 | 5.44 | 5.72 | 11.22 | 7,744,179 | 44,299,249 |
| *1997 | 6.5 | 92,883,712 | 0.9912 | 6.47 | 5.40 | 11.90 | 7,805,562 | 42,147,562 |
| *1996 | 7.5 | 91,141,285 | 0.9875 | 7.45 | 5.15 | 12.65 | 7,207,568 | 37,084,525 |
| *1995 | 8.5 | 69,927,991 | 0.9868 | 8.45 | 4.94 | 13.44 | 5,204,611 | 25,688,800 |
| *1994 | 9.5 | 44,263,132 | 0.9795 | 9.40 | 4.76 | 14.26 | 3,104,629 | 14,769,152 |
| *1993 | 10.5 | 33,488,287 | 0.9800 | 10.38 | 4.60 | 15.10 | 2,218,457 | 10,194,487 |
| *1992 | 11.5 | 35,981,118 | 0.9816 | 11.41 | 4.44 | 15.94 | 2,257,470 | 10,020,213 |
| *1991 | 12.5 | 34,697,266 | 0.9707 | 12.32 | 4.28 | 16.78 | 2,067,900 | 8,848,517 |
| *1990 | 13.5 | 34,346,643 | 0.9616 | 13.22 | 4.11 | 17.61 | 1,950,237 | 8,018,449 |
| *1989 | 14.5 | 40,979,775 | 0.9662 | 14.25 | 3.94 | 18.44 | 2,222,842 | 8,748,566 |
| *1988 | 15.5 | 47,281,737 | 0.9603 | 15.20 | 3.75 | 19.25 | 2,455,831 | 9,216,354 |
| *1987 | 16.5 | 57,779,416 | 0.9417 | 16.10 | 3.57 | 20.07 | 2,879,508 | 10,267,527 |
| *1986 | 17.5 | 51,397,405 | 0.9501 | 17.15 | 3.38 | 20.88 | 2,461,809 | 8,315,752 |
| *1985 | 18.5 | 59,990,601 | 0.4315 | 16.11 | 3.19 | 21.69 | 2,765,671 | 8,825,696 |
| *1984 | 19.5 | 53,499,362 | 0.9200 | 18.65 | 3.01 | 22.51 | 2,376,930 | 7,149,217 |
| *1983 | 20.5 | 38,354,000 | 0.9296 | 19.79 | 2.83 | 23.33 | 1,644,078 | 4,650,409 |
| *1982 | 21.5 | 50,176,909 | 0.9300 | 20.79 | 2.65 | 24.15 | 2,077,371 | 5,513,441 |
| 1981 | 22.5 | 21,061,546 | 0.9212 | 21.54 | 2.66 | 23.98 | 878,151 | 2,332,941 |
| 1980 | 23.5 | 20,006,214 | 0.9022 | 22.23 | 2.47 | 24.45 | 818,219 | 2,017,531 |
| 1979 | 24.5 | 19,527,131 | 0.9175 | 23.44 | 2.28 | 25.54 | 764,601 | 1,746,128 |
| 1978/PRIOR | | 164,748,269 | 0.5066 | 26.38 | 1.23 | 27.31 | 6,032,162 | 7,400,469 |
| TOTAL | | 1,644,110,671 | | | | | 117,928,224 | 634,345,674 |
| NON-ELG V | | 225,343,160 | | | | | 8,493,133 | 13,497,069 |
| ELG V | | 1,418,767,511 | | | | | 109,435,091 | 620,848,606 |

| AVG SERVICE LIFE: | ALL VINTS | NELG VINTS | ELG VINTS |
|---|---|---|---|
| TOT B/TOT G | 13.94162 | 26.53240 | 12.96447 |
| AVG REMAINING LIFE: | ALL VINTS | NELG VINTS | ELG VINTS |
| TOT H/TOT G | 5.37908 | 1.58917 | 5.67321 |

COMPUTED GROSS ADDS-ALL VINTS:
SUM OF (B/C) 1,928,901,066

AVG PROPORTION SURVIVING:
B/ SUM OF (B/C) 0.85236

USING IOWA CURVE: L1.5
* ELG VINTAGES, PROJECTION LIFE 12.0
++ FROM TABLE 2-VG/ELG; COL H FOR ELG, COL I FOR VG
+++ FROM TABLE 2-VG/ELG FOR ELG VINTAGES, COMPUTED AS D+(C*E) FOR VG VINTAGES
& ACTUAL

Company: Qwest - Arizona
Account: 2423 Buried Cable Metallic

## Generation Arrangement

| Vintage | Age | Experience to 1/1/2004 Amount Surviving | Proportion Surviving | Realized Life |
|---|---|---|---|---|
| A | B | C | D | E |
| 2003 | 0.5 | 63,550,598 | 0.9997 | 0.50 |
| 2002 | 1.5 | 68,916,847 | 0.9879 | 1.49 |
| 2001 | 2.5 | 119,473,541 | 0.9849 | 2.47 |
| 2000 | 3.5 | 141,529,013 | 0.9832 | 3.47 |
| 1999 | 4.5 | 102,216,637 | 0.9634 | 4.41 |
| 1998 | 5.5 | 86,892,236 | 0.9781 | 5.44 |
| 1997 | 6.5 | 92,883,712 | 0.9912 | 6.47 |
| 1996 | 7.5 | 91,141,285 | 0.9875 | 7.45 |
| 1995 | 8.5 | 69,927,991 | 0.9868 | 8.45 |
| 1994 | 9.5 | 44,263,132 | 0.9795 | 9.40 |
| 1993 | 10.5 | 33,488,287 | 0.9800 | 10.38 |
| 1992 | 11.5 | 35,981,118 | 0.9816 | 11.41 |
| 1991 | 12.5 | 34,697,266 | 0.9707 | 12.32 |
| 1990 | 13.5 | 34,346,643 | 0.9616 | 13.22 |
| 1989 | 14.5 | 40,979,775 | 0.9662 | 14.25 |
| 1988 | 15.5 | 47,281,737 | 0.9603 | 15.20 |
| 1987 | 16.5 | 57,779,416 | 0.9417 | 16.10 |
| 1986 | 17.5 | 51,397,405 | 0.9501 | 17.15 |
| 1985 | 18.5 | 59,990,601 | 0.4315 | 16.11 |
| 1984 | 19.5 | 53,499,362 | 0.9200 | 18.65 |
| 1983 | 20.5 | 38,354,000 | 0.9296 | 19.79 |
| 1982 | 21.5 | 50,176,909 | 0.9300 | 20.79 |
| 1981 | 22.5 | 21,061,546 | 0.9212 | 21.54 |
| 1980 | 23.5 | 20,006,214 | 0.9022 | 22.23 |
| 1979 | 24.5 | 19,527,131 | 0.9175 | 23.44 |
| 1978 | 25.5 | 17,663,610 | 0.9136 | 24.38 |
| 1977 | 26.5 | 11,938,044 | 0.8707 | 24.85 |
| 1976 | 27.5 | 8,522,878 | 0.8745 | 25.76 |
| 1975 | 28.5 | 7,285,589 | 0.7358 | 25.23 |
| 1974 | 29.5 | 13,335,239 | 0.7874 | 26.52 |
| 1973 | 30.5 | 22,447,435 | 0.7435 | 27.08 |
| 1972 | 31.5 | 12,266,613 | 0.6481 | 27.71 |
| 1971 | 32.5 | 12,159,835 | 0.6692 | 27.79 |
| 1970 | 33.5 | 12,104,735 | 0.6718 | 28.34 |
| 1969 | 34.5 | 7,867,593 | 0.5899 | 28.48 |
| 1968 | 35.5 | 4,092,856 | 0.6044 | 29.04 |
| 1967 | 36.5 | 3,304,809 | 0.5992 | 29.51 |
| 1966 | 37.5 | 3,348,121 | 0.6135 | 31.34 |
| 1965 | 38.5 | 2,036,749 | 0.6131 | 32.12 |
| 1964 | 39.5 | 2,717,453 | 0.6223 | 32.05 |
| 1963 | 40.5 | 2,538,316 | 0.5881 | 32.74 |
| 1962 | 41.5 | 1,471,783 | 0.5783 | 33.54 |
| 1961 | 42.5 | 1,084,117 | 0.4718 | 33.16 |
| 1960 | 43.5 | 823,545 | 0.3702 | 30.23 |
| 1959 | 44.5 | 289,326 | 0.4011 | 31.57 |
| 1958 | 45.5 | 184,169 | 0.2750 | 29.71 |
| 1957 | 46.5 | 224,482 | 0.2054 | 26.75 |
| 1956 | 47.5 | 449,632 | 0.2030 | 26.12 |
| 1955 | 48.5 | 156,131 | 0.1609 | 25.36 |

Company: Qwest - Arizona
Account: 2423 Buried Cable Metallic

## Generation Arrangement

| | | Experience to 1/1/2004 | | |
|---|---|---|---|---|
| | | Amount | Proportion | Realized |
| Vintage | Age | Surviving | Surviving | Life |
| A | B | C | D | E |
| 1954 | 49.5 | 251,252 | 0.1464 | 29.57 |
| 1953 | 50.5 | 53,309 | 0.0711 | 26.84 |
| 1952 | 51.5 | 90,420 | 0.2333 | 32.94 |
| 1951 | 52.5 | 4,091 | 0.0385 | 26.52 |
| 1950 | 53.5 | 2,444 | 0.0124 | 23.89 |
| 1949 | 54.5 | 10,083 | 0.0707 | 24.04 |
| 1948 | 55.5 | 3,151 | 0.2004 | 28.63 |
| 1947 | 56.5 | 317 | 0.0036 | 35.50 |
| 1946 | 57.5 | 361 | 0.0476 | 36.30 |
| 1945 | 58.5 | 1,303 | 0.1437 | 36.74 |
| 1944 | 59.5 | 0 | 0.0000 | 0.00 |
| 1943 | 60.5 | 0 | 0.0000 | 0.00 |
| 1942 | 61.5 | 6,996 | 0.1661 | 36.94 |
| 1941 | 62.5 | 60,465 | 0.1683 | 37.12 |
| 1940 | 63.5 | 2,340 | 0.0682 | 32.32 |
| 1939 | 64.5 | 0 | 0.0000 | 0.00 |
| 1938 | 65.5 | 1,619 | 0.2709 | 36.70 |
| 1937 | 66.5 | 227 | 0.0041 | 28.74 |
| 1936 | 67.5 | 4,958 | 0.0240 | 32.31 |
| 1935 | 68.5 | 0 | 0.0000 | 0.00 |
| 1934 | 69.5 | 0 | 0.0000 | 0.00 |
| 1933 | 70.5 | 0 | 0.0000 | 0.00 |
| 1932 | 71.5 | 0 | 0.0000 | 0.00 |
| 1931 | 72.5 | 92 | 0.0851 | 26.84 |
| 1930 | 73.5 | 2,284 | 0.1157 | 24.10 |
| 1929 | 74.5 | 0 | 0.0000 | 0.00 |
| 1928 | 75.5 | 0 | 0.0000 | 0.00 |
| 1927 | 76.5 | 0 | 0.0000 | 0.00 |
| 1926 | 77.5 | 0 | 0.0000 | 0.00 |
| 1925 | 78.5 | 15,939,497 | 0.1445 | 21.20 |
| **Total** | | **1,644,110,671** | | |

Source:
All data from the text delimited filed "WAZGCO.FCC"
provided by Qwest in response to WDA 01-01.

Arizona
T-01051B-03-0454
WDA 02-006S1

INTERVENOR: William W. Dunkel and Associates

REQUEST NO: 006S1

For each depreciable account Qwest should provide the "observed life" points for the most recent "band" of years (The most recent "band" is the years 2001-2003 inclusive. (The "observed life" points are the percentages of investment surviving at each age. These are standard depreciation terms). This is the same Observed Life information as Qwest provided in the Depreciation Rate Study Qwest filed in Arizona the last time Qwest requested a change in depreciation rates (Docket Number T-01051B-97-0689), except data through 12-31-2003 is requested.

This request does not ask that Qwest fit curves to the "observed life" data.

RESPONSE:

Qwest did not develop "Observed Life Information" as part of its depreciation Technical Update. To be responsive to this request, Qwest will perform the special study required to produce the historical retirement based "observed life" data. Because of the time and resources involved with such a study, Qwest will provide the data on or before July 2, 2004.

Respondent: Dennis Wu

SUPPLEMENTAL RESPONSE DATED 07/02/04:

Please see Non-Confidential Attachment A. Qwest has provided the observed life points for all accounts studied on a "Full Mortality" basis. This is consistant with exhibits filed in the previous Arizona Depreciation Rate Study. Accounts studied on a "Computed Mortality" basis do not produce observed life points and are not included in Attachment A. The "Computed Mortality" accounts are: 2114 Special Purpose Vehicles, 2115 Garage Work Equipment, 2116 Other Work Equipment, 2123.2 Stand Alone, and 2431 Aerial Wire.

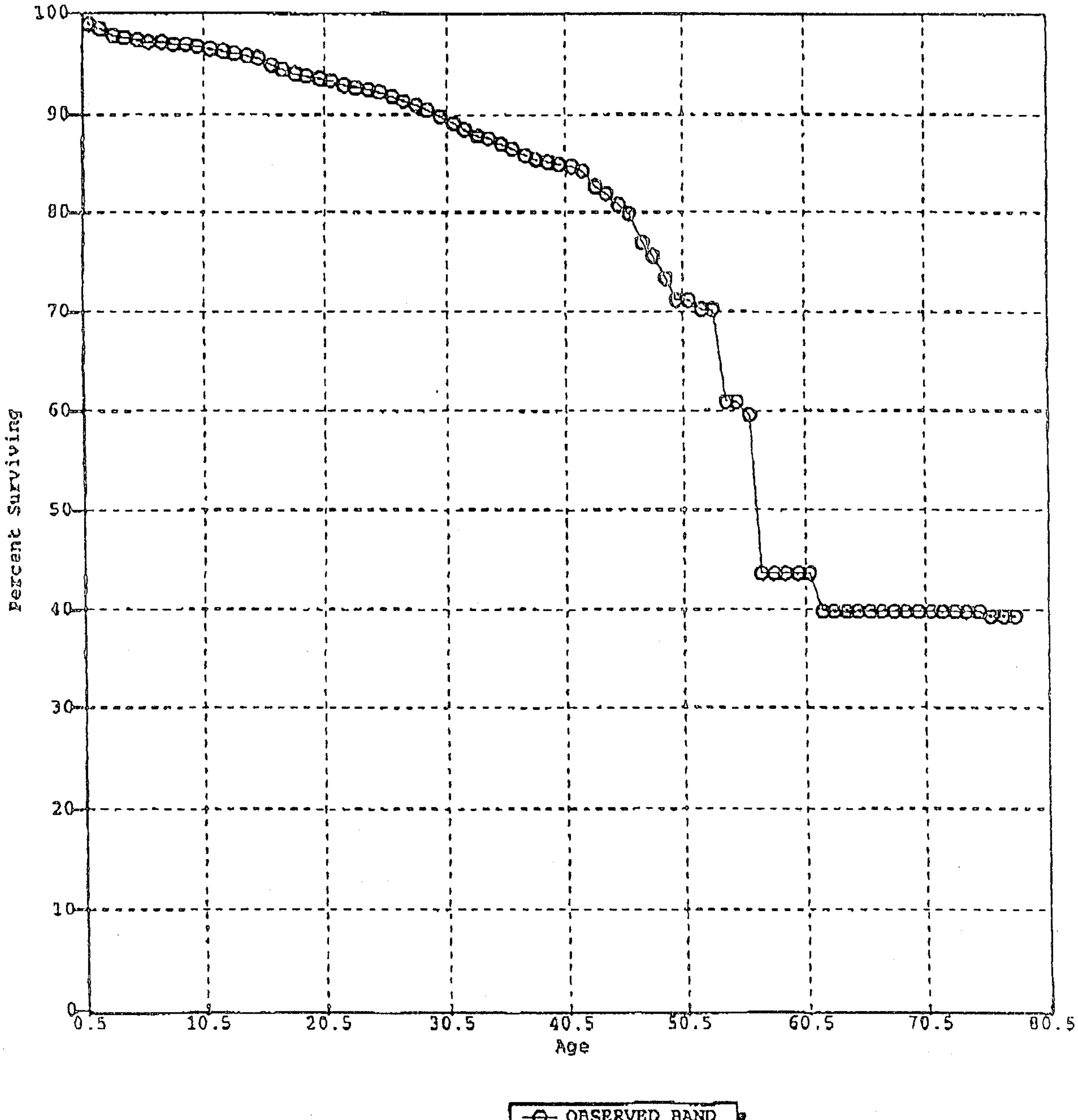
Respondent: Dennis Wu

ARIZONA
DOCKET NO. T01051B-03-0454
WDA 02-0691
ATTACHMENT A

DATE: 6/21/2004

COMPANY: QWEST CORPORATION
STATE: ARIZONA
ACCOUNT: 2423 BURIED CABLE TOTAL
CATEGORY: 2423 BURIED CABLE TOTAL

CURVE SHAPE COMPARISION
BAND=0103




CURVES SCALED TO THE OBSERVED LIFE OF 58.8

Company: Qwest - Arizona
Account: 2423 Buried Cable Metallic

Avg Life: 23.0
Iowa Curv L1.5

## Generation Arrangement (Staff Recommendation)

| | Vintage | Age | Experience to 1/1/2004 Amount Surviving | Proportion Surviving | Realized Life | Average Remaining Life | Average Service Life | Average Life Weights | Remaining Life Weights | Computed Original Investment |
|---|---|---|---|---|---|---|---|---|---|---|
| | A | B | C | D | E | F | G | H=C/G | I=F*H | J=C/D |
| * | 2003 | 0.5 | 63,550,598 | 0.999716 | 0.50 | 15.88 | 16.38 | 3,880,694 | 61,610,251 | 63,568,646 |
| * | 2002 | 1.5 | 68,916,847 | 0.987931 | 1.49 | 15.41 | 16.91 | 4,075,112 | 62,804,179 | 69,758,742 |
| * | 2001 | 2.5 | 119,473,541 | 0.984909 | 2.47 | 14.85 | 17.35 | 6,887,478 | 102,254,845 | 121,304,171 |
| * | 2000 | 3.5 | 141,529,013 | 0.983217 | 3.47 | 14.28 | 17.78 | 7,960,224 | 113,668,230 | 143,944,861 |
| * | 1999 | 4.5 | 102,216,637 | 0.963392 | 4.41 | 13.73 | 18.23 | 5,606,496 | 76,987,405 | 106,100,753 |
| * | 1998 | 5.5 | 86,892,236 | 0.978074 | 5.44 | 13.21 | 18.71 | 4,644,739 | 61,346,169 | 88,840,134 |
| * | 1997 | 6.5 | 92,883,712 | 0.991171 | 6.47 | 12.71 | 19.21 | 4,835,520 | 61,452,830 | 93,711,117 |
| * | 1996 | 7.5 | 91,141,285 | 0.987499 | 7.45 | 12.23 | 19.73 | 4,619,086 | 56,498,140 | 92,295,053 |
| * | 1995 | 8.5 | 69,927,991 | 0.986783 | 8.45 | 11.78 | 20.28 | 3,448,799 | 40,613,196 | 70,864,604 |
| * | 1994 | 9.5 | 44,263,132 | 0.979483 | 9.40 | 11.35 | 20.85 | 2,122,642 | 24,098,028 | 45,190,292 |
| * | 1993 | 10.5 | 33,488,287 | 0.979959 | 10.38 | 10.97 | 21.47 | 1,559,892 | 17,109,418 | 34,173,144 |
| * | 1992 | 11.5 | 35,981,118 | 0.981579 | 11.41 | 10.63 | 22.13 | 1,626,245 | 17,279,305 | 36,656,349 |
| * | 1991 | 12.5 | 34,697,266 | 0.970713 | 12.32 | 10.32 | 22.82 | 1,520,273 | 15,693,851 | 35,744,088 |
| * | 1990 | 13.5 | 34,346,643 | 0.961611 | 13.22 | 10.06 | 23.56 | 1,458,115 | 14,662,089 | 35,717,805 |
| * | 1989 | 14.5 | 40,979,775 | 0.966155 | 14.25 | 9.82 | 24.32 | 1,685,324 | 16,542,574 | 42,415,332 |
| * | 1988 | 15.5 | 47,281,737 | 0.960292 | 15.20 | 9.60 | 25.10 | 1,883,825 | 18,082,455 | 49,236,812 |
| * | 1987 | 16.5 | 57,779,416 | 0.941736 | 16.10 | 9.40 | 25.90 | 2,230,764 | 20,971,808 | 61,354,147 |
| * | 1986 | 17.5 | 51,397,405 | 0.950074 | 17.15 | 9.22 | 26.72 | 1,923,629 | 17,733,890 | 54,098,321 |
| * | 1985 | 18.5 | 59,990,601 | 0.431542 | 16.11 | 9.05 | 27.55 | 2,177,663 | 19,703,827 | 139,014,362 |
| * | 1984 | 19.5 | 53,499,362 | 0.920023 | 18.65 | 8.89 | 28.39 | 1,884,747 | 16,746,802 | 58,149,998 |
| * | 1983 | 20.5 | 38,354,000 | 0.929587 | 19.79 | 8.73 | 29.23 | 1,312,277 | 11,452,331 | 41,259,171 |
| * | 1982 | 21.5 | 50,176,909 | 0.930020 | 20.79 | 8.57 | 30.07 | 1,668,653 | 14,300,868 | 53,952,528 |
| | 1981 | 22.5 | 21,061,546 | 0.921153 | 21.54 | 10.02 | 30.76 | 684,658 | 6,856,864 | 22,864,318 |
| | 1980 | 23.5 | 20,006,214 | 0.902218 | 22.23 | 9.75 | 31.02 | 644,944 | 6,286,170 | 22,174,469 |
| | 1979 | 24.5 | 19,527,131 | 0.917524 | 23.44 | 9.48 | 32.14 | 607,509 | 5,759,982 | 21,282,411 |
| | 1978 | 25.5 | 17,663,610 | 0.913623 | 24.38 | 9.22 | 32.80 | 538,489 | 4,963,760 | 19,333,595 |
| | 1977 | 26.5 | 11,938,044 | 0.870708 | 24.85 | 8.96 | 32.65 | 365,678 | 3,274,935 | 13,710,734 |
| | 1976 | 27.5 | 8,522,878 | 0.874516 | 25.76 | 8.69 | 33.36 | 255,456 | 2,221,121 | 9,745,821 |
| | 1975 | 28.5 | 7,285,589 | 0.735790 | 25.23 | 8.44 | 31.43 | 231,779 | 1,955,110 | 9,901,718 |
| | 1974 | 29.5 | 13,335,239 | 0.787381 | 26.52 | 8.18 | 32.96 | 404,628 | 3,308,821 | 16,936,194 |
| | 1973 | 30.5 | 22,447,435 | 0.743466 | 27.08 | 7.92 | 32.97 | 680,858 | 5,393,743 | 30,192,952 |
| | 1972 | 31.5 | 12,266,613 | 0.648086 | 27.71 | 7.67 | 32.68 | 375,348 | 2,878,749 | 18,927,433 |
| | 1971 | 32.5 | 12,159,835 | 0.669171 | 27.79 | 7.42 | 32.75 | 371,266 | 2,754,956 | 18,171,481 |
| | 1970 | 33.5 | 12,104,735 | 0.671782 | 28.34 | 7.18 | 33.16 | 365,070 | 2,619,452 | 18,018,831 |
| | 1969 | 34.5 | 7,867,593 | 0.589900 | 28.48 | 6.93 | 32.57 | 241,537 | 1,674,880 | 13,337,163 |
| | 1968 | 35.5 | 4,092,856 | 0.604431 | 29.04 | 6.70 | 33.09 | 123,684 | 828,407 | 6,771,414 |
| | 1967 | 36.5 | 3,304,809 | 0.599154 | 29.51 | 6.47 | 33.38 | 99,002 | 640,180 | 5,515,796 |
| | 1966 | 37.5 | 3,348,121 | 0.613466 | 31.34 | 6.24 | 35.17 | 95,207 | 594,122 | 5,457,714 |
| | 1965 | 38.5 | 2,036,749 | 0.613094 | 32.12 | 6.02 | 35.81 | 56,875 | 342,293 | 3,322,081 |
| | 1964 | 39.5 | 2,717,453 | 0.622303 | 32.05 | 5.80 | 35.66 | 76,198 | 442,083 | 4,366,765 |
| | 1963 | 40.5 | 2,538,316 | 0.588080 | 32.74 | 5.59 | 36.03 | 70,450 | 393,837 | 4,316,280 |
| | 1962 | 41.5 | 1,471,783 | 0.578314 | 33.54 | 5.38 | 36.65 | 40,154 | 216,145 | 2,544,955 |
| | 1961 | 42.5 | 1,084,117 | 0.471812 | 33.16 | 5.18 | 35.60 | 30,450 | 157,753 | 2,297,771 |
| | 1960 | 43.5 | 823,545 | 0.370227 | 30.23 | 4.98 | 32.08 | 25,672 | 127,930 | 2,224,434 |
| | 1959 | 44.5 | 289,326 | 0.401073 | 31.57 | 4.79 | 33.49 | 8,640 | 41,383 | 721,379 |
| | 1958 | 45.5 | 184,169 | 0.274988 | 29.71 | 4.60 | 30.98 | 5,945 | 27,354 | 669,734 |
| | 1957 | 46.5 | 224,482 | 0.205434 | 26.75 | 4.42 | 27.66 | 8,115 | 35,845 | 1,092,720 |
| | 1956 | 47.5 | 449,632 | 0.203020 | 26.12 | 4.24 | 26.98 | 16,666 | 70,608 | 2,214,723 |
| | 1955 | 48.5 | 156,131 | 0.160886 | 25.36 | 4.06 | 26.01 | 6,002 | 24,376 | 970,448 |
| | 1954 | 49.5 | 251,252 | 0.146353 | 29.57 | 3.89 | 30.14 | 8,336 | 32,425 | 1,716,751 |

Company: Qwest - Arizona
Account: 2423 Buried Cable Metallic

Avg Life: 23.0
Iowa Curv L1.5

## Generation Arrangement (Staff Recommendation)

| | | Experience to 1/1/2004 | | | Average | Average | Average | Remaining | Computed |
|---|---|---|---|---|---|---|---|---|---|
| | | Amount | Proportion | Realized | Remaining | Service | Life | Life | Original |
| Vintage | Age | Surviving | Surviving | Life | Life | Life | Weights | Weights | Investment |
| A | B | C | D | E | F | G | H=C/G | I=F*H | J=C/D |
| 1953 | 50.5 | 53,309 | 0.071082 | 26.84 | 3.72 | 27.10 | 1,967 | 7,322 | 749,961 |
| 1952 | 51.5 | 90,420 | 0.233334 | 32.94 | 3.56 | 33.77 | 2,677 | 9,530 | 387,513 |
| 1951 | 52.5 | 4,091 | 0.038511 | 26.52 | 3.40 | 26.65 | 154 | 522 | 106,229 |
| 1950 | 53.5 | 2,444 | 0.012415 | 23.89 | 3.24 | 23.93 | 102 | 331 | 196,866 |
| 1949 | 54.5 | 10,083 | 0.070657 | 24.04 | 3.09 | 24.26 | 416 | 1,286 | 142,703 |
| 1948 | 55.5 | 3,151 | 0.200361 | 28.63 | 2.94 | 29.22 | 108 | 318 | 15,727 |
| 1947 | 56.5 | 317 | 0.003611 | 35.50 | 2.80 | 35.51 | 9 | 25 | 87,786 |
| 1946 | 57.5 | 361 | 0.047594 | 36.30 | 2.65 | 36.43 | 10 | 26 | 7,585 |
| 1945 | 58.5 | 1,303 | 0.143664 | 36.74 | 2.51 | 37.10 | 35 | 88 | 9,070 |
| 1944 | 59.5 | 0 | 0.000000 | 0.00 | 0.00 | 0.00 | 0 | 0 | 0 |
| 1943 | 60.5 | 0 | 0.000000 | 0.00 | 0.00 | 0.00 | 0 | 0 | 0 |
| 1942 | 61.5 | 6,996 | 0.166104 | 36.94 | 2.07 | 37.28 | 188 | 388 | 42,118 |
| 1941 | 62.5 | 60,465 | 0.168268 | 37.12 | 1.91 | 37.44 | 1,615 | 3,083 | 359,338 |
| 1940 | 63.5 | 2,340 | 0.068177 | 32.32 | 1.75 | 32.44 | 72 | 126 | 34,322 |
| 1939 | 64.5 | 0 | 0.000000 | 0.00 | 0.00 | 0.00 | 0 | 0 | 0 |
| 1938 | 65.5 | 1,619 | 0.270900 | 36.70 | 1.40 | 37.07 | 44 | 61 | 5,976 |
| 1937 | 66.5 | 227 | 0.004100 | 28.74 | 1.19 | 28.75 | 8 | 9 | 55,366 |
| 1936 | 67.5 | 4,958 | 0.023955 | 32.31 | 0.93 | 32.33 | 153 | 143 | 206,972 |
| 1935 | 68.5 | 0 | 0.000000 | 0.00 | 0.00 | 0.00 | 0 | 0 | 0 |
| 1934 | 69.5 | 0 | 0.000000 | 0.00 | 0.00 | 0.00 | 0 | 0 | 0 |
| 1933 | 70.5 | 0 | 0.000000 | 0.00 | 0.00 | 0.00 | 0 | 0 | 0 |
| 1932 | 71.5 | 0 | 0.000000 | 0.00 | 0.00 | 0.00 | 0 | 0 | 0 |
| 1931 | 72.5 | 92 | 0.085093 | 26.84 | 0.50 | 26.89 | 3 | 2 | 1,081 |
| 1930 | 73.5 | 2,284 | 0.115662 | 24.10 | 0.50 | 24.16 | 95 | 47 | 19,747 |
| 1929 | 74.5 | 0 | 0.000000 | 0.00 | 0.00 | 0.00 | 0 | 0 | 0 |
| 1928 | 75.5 | 0 | 0.000000 | 0.00 | 0.00 | 0.00 | 0 | 0 | 0 |
| 1927 | 76.5 | 0 | 0.000000 | 0.00 | 0.00 | 0.00 | 0 | 0 | 0 |
| 1926 | 77.5 | 0 | 0.000000 | 0.00 | 0.00 | 0.00 | 0 | 0 | 0 |
| 1925 | 78.5 | 15,939,497 | 0.144481 | 21.20 | 0.50 | 21.28 | 749,152 | 374,576 | 110,322,184 |
| Total | | 1,644,110,671 | | | | | 76,207,620 | 915,933,657 | 1,928,901,062 |
| Non-ELG | | 225,343,160 | | | | | 7,195,420 | 54,321,166 | 391,550,633 |
| ELG | | 1,418,767,511 | | | | | 69,012,199 | 861,612,490 | 1,537,350,429 |

| | All Vintages | Non-ELG Vintages | ELG Vintages |
|---|---|---|---|
| **Average Service Life:** (col C/ col H) | **21.57** | 31.32 | 20.56 |
| **Average Remaining Life:** (col I/ col H) | **12.02** | 7.55 | 12.48 |

# STATEMENT A
## SUMMARY OF DEPRECIATION RATES

| Account Number | Category | Rates Effective 12/31/03 Remaining Life Years | Reserve % | Future Net Salvage % | Depreciation Rate % | Update Reserve to 12/31/03 Remaining Life Years | Reserve % | Future Net Salvage % | Depreciation Rate % | Adjust Lives and Salvage Parameters Remaining Life Years | Reserve % | Future Net Salvage % | Depreciation Rate % |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | A | B | C | D | E | F | G | H | I | J | K | L |
| 2112 | Motor Vehicles | 3.6 | 66.4% | 16.0% | 4.9% | 3.8 | 57.7% | 16.0% | 6.9% | 3.8 | 57.7% | 16.0% | 6.9% |
| 2114 | Special Pupose Vehicles | 9.8 | 0.0% | 0.0% | 10.2% | 4.4 | 43.9% | 0.0% | 12.8% | 4.4 | 43.9% | 0.0% | 12.8% |
| 2115 | Garage Work Equipment | 10.2 | -55.1% | -4.0% | 15.6% | 9.1 | -17.2% | -4.0% | 13.3% | 9.1 | -17.2% | -4.0% | 13.3% |
| 2116 | Other Work Equipment | 5.4 | 7.2% | 7.0% | 15.9% | 6.7 | 44.6% | 7.0% | 7.2% | 6.7 | 44.6% | 7.0% | 7.2% |
| 2121 | Buildings | 26.0 | 29.2% | -6.0% | 3.0% | 24.0 | 27.6% | -6.0% | 3.3% | 24.0 | 27.6% | -6.0% | 3.3% |
| 2122 | Furniture | 5.5 | -10.8% | 0.0% | 20.1% | 6.8 | 72.6% | 0.0% | 4.0% | 6.8 | 72.6% | 0.0% | 4.0% |
| 2123.1 | Office Equipment | 3.3 | 26.3% | 0.0% | 22.3% | 2.5 | 102.4% | 0.0% | 0.0% | 2.5 | 102.4% | 0.0% | 0.0% |
| 2123.2 | Company Communications Equipment | 5.3 | 67.7% | 0.0% | 6.1% | 4.6 | 92.3% | 0.0% | 1.7% | 4.6 | 92.3% | 0.0% | 1.7% |
| 2124 | General Purpose Computer | 2.4 | 72.4% | 5.0% | 9.4% | 1.7 | 95.9% | 5.0% | 0.0% | 1.7 | 95.9% | 5.0% | 0.0% |
| 2212 | Digital Switching Equipment | 5.4 | 37.5% | 3.0% | 11.0% | 5.2 | 54.9% | 3.0% | 8.1% | 8.3 | 54.9% | 0.0% | 5.4% |
| 2220 | Operator Systems | 4.1 | 96.6% | -3.0% | 1.6% | 3.8 | 5.1% | -3.0% | 25.8% | 3.8 | 5.1% | -3.0% | 25.8% |
| 2231 | Radio Systems | 6.6 | 64.0% | -2.0% | 5.8% | 5.0 | 98.3% | -2.0% | 0.7% | 5.0 | 98.3% | -2.0% | 0.7% |
| 2232 | Circuit DDS | 4.0 | 75.4% | 3.0% | 5.4% | 3.4 | 90.2% | 3.0% | 2.0% | 3.9 | 90.2% | 0.0% | 2.5% |
| 2232 | Circuit Digital | 5.1 | 47.8% | 2.0% | 9.8% | 5.3 | 60.6% | 2.0% | 7.1% | 6.3 | 60.6% | 0.0% | 6.3% |
| 2232 | Circuit Analog | 3.3 | 89.3% | 0.0% | 3.2% | 2.8 | 101.3% | 0.0% | 0.0% | 3.6 | 101.3% | 0.0% | 0.0% |
| 2362 | Other Terminal Equipment | 6.4 | 49.9% | 2.0% | 7.5% | 6.5 | 56.4% | 2.0% | 6.4% | 6.5 | 56.4% | 2.0% | 6.4% |
| 2411 | Pole Lines | 26.0 | 71.6% | -138.0% | 6.4% | 25.0 | 90.3% | -138.0% | 5.9% | 24.7 | 90.3% | -75.0% | 3.4% |
| 2421 | Aerial Cable - Metallic | 5.2 | 61.5% | -27.0% | 12.6% | 5.0 | 104.9% | -27.0% | 4.4% | 11.4 | 104.9% | -35.0% | 2.6% |
| 2421 | Aerial Cable - Non Metallic | 13.1 | 12.5% | -27.0% | 8.7% | 8.7 | 44.0% | -27.0% | 9.5% | 21.7 | 44.0% | -17.5% | 3.4% |
| 2422 | Underground Cable - Metallic | 5.8 | 50.8% | -6.0% | 9.5% | 5.5 | 83.1% | -6.0% | 4.2% | 13.3 | 83.1% | -30.0% | 3.5% |
| 2422 | Underground Cable - Non Metallic | 7.7 | 26.5% | -6.0% | 10.3% | 6.8 | 49.7% | -6.0% | 8.3% | 21.1 | 49.7% | -6.0% | 2.7% |
| 2423 | Buried Cable - Metallic | 5.6 | 40.0% | -7.0% | 12.0% | 5.4 | 71.7% | -7.0% | 6.5% | 12.0 | 71.7% | -10.0% | 3.2% |
| 2423 | Buried Cable - Non Metallic | 12.9 | 24.8% | -7.0% | 6.4% | 8.7 | 49.3% | -7.0% | 6.6% | 18.6 | 49.3% | -5.0% | 3.0% |
| 2424 | Submarine Cable - Metallic | 1.4 | -20.6% | 0.0% | 86.1% | 0.5 | 121.6% | 0.0% | 0.0% | 0.5 | 121.6% | -1.0% | 0.0% |
| 2424 | Submarine Cable - Non Metallic | 9.0 | 0.0% | 0.0% | 11.1% | 0.0 | 0.0% | 0.0% | 0.0% | 0.0 | 0.0% | 0.0% | 0.0% |
| 2426 | Intrabuilding Cable - Metallic | 8.3 | 70.7% | 0.0% | 3.5% | 7.7 | 76.8% | 0.0% | 3.0% | 9.5 | 76.8% | 0.0% | 2.4% |
| 2426 | Intrabuilding Cable - Non Metallic | 6.1 | 20.2% | 0.0% | 13.1% | 6.2 | 61.2% | 0.0% | 6.3% | 14.6 | 61.2% | 0.0% | 2.7% |
| 2431 | Aerial Wire | 5.5 | 16.8% | -30.0% | 20.6% | 5.3 | 90.5% | -30.0% | 7.5% | 10.2 | 90.5% | -40.0% | 4.9% |
| 2441 | Conduit Systems | 44.0 | 21.1% | -20.0% | 2.2% | 43.0 | 23.8% | -20.0% | 2.2% | 42.9 | 23.8% | -20.0% | 2.2% |

**STATEMENT B**
**INTRASTATE BASIS**
**CHANGE IN ANNUAL DEPRECIATION ACCRUALS**
**RESULTING FROM CHANGES IN DEPRECIATION RATES**
**($000)**

| Account Number | Category | Investment 1/1/04 | Rates Effective 12/31/03 Rate Amount | Amortization Amount | Total | Update Reserve to 12/31/03 Rate Amount | Amortization Amount | Total | Change in Accruals | Adjust Lives and Salvage Parameters Rate Amount | Amortization Amount | Total | Change in Accruals |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | M | N=D*M | O | P=N+O | Q=H*M | R | S=Q+R | T=S-P | U=L*M | V | W=U+V | X=W-P |
| 2112 | Motor Vehicles | 50,002 | 2,450 | 0 | 2,450 | 3,450 | 0 | 3,450 | 1,000 | 3,450 | 0 | 3,450 | 1,000 |
| 2114 | Special Pupose Vehicles | 18 | 2 | 0 | 2 | 2 | 0 | 2 | 0 | 2 | 0 | 2 | 0 |
| 2115 | Garage Work Equipment | 1,075 | 168 | 0 | 168 | 143 | 0 | 143 | -25 | 143 | 0 | 143 | -25 |
| 2116 | Other Work Equipment | 27,124 | 4,313 | 0 | 4,313 | 1,953 | 0 | 1,953 | -2,360 | 1,953 | 0 | 1,953 | -2,360 |
| 2121 | Buildings | 168,555 | 5,057 | 0 | 5,057 | 5,562 | 0 | 5,562 | 506 | 5,562 | 0 | 5,562 | 506 |
| 2122 | Furniture | 1,253 | 252 | 0 | 252 | 50 | 0 | 50 | -202 | 50 | 0 | 50 | -202 |
| 2123.1 | Office Equipment | 4,186 | 933 | 0 | 933 | 0 | 0 | 0 | -933 | 0 | 0 | 0 | -933 |
| 2123.2 | Company Communications Equipment | 1,719 | 105 | 0 | 105 | 29 | 0 | 29 | -76 | 29 | 0 | 29 | -76 |
| 2124 | General Purpose Computer | 68,171 | 6,408 | 0 | 6,408 | 0 | 0 | 0 | -6,408 | 0 | 0 | 0 | -6,408 |
| 2212 | Digital Switching Equipment | 899,493 | 98,944 | 0 | 98,944 | 72,859 | 0 | 72,859 | -26,085 | 48,573 | 0 | 48,573 | -50,372 |
| 2220 | Operator Systems | 1,962 | 31 | 0 | 31 | 506 | 0 | 506 | 475 | 506 | 0 | 506 | 475 |
| 2231 | Radio Systems | 20,998 | 1,218 | 0 | 1,218 | 147 | 0 | 147 | -1,071 | 147 | 0 | 147 | -1,071 |
| 2232 | Circuit DDS | 3,517 | 190 | 0 | 190 | 70 | 0 | 70 | -120 | 88 | 0 | 88 | -102 |
| 2232 | Circuit Digital | 1,084,182 | 106,250 | 0 | 106,250 | 76,977 | 0 | 76,977 | -29,273 | 68,303 | 0 | 68,303 | -37,946 |
| 2232 | Circuit Analog | 25,342 | 811 | 0 | 811 | 0 | 0 | 0 | -811 | 0 | 0 | 0 | -811 |
| 2362 | Other Terminal Equipment | 51,022 | 3,827 | 0 | 3,827 | 3,265 | 0 | 3,265 | -561 | 3,265 | 0 | 3,265 | -561 |
| 2411 | Pole Lines | 38,664 | 2,475 | 0 | 2,475 | 2,281 | 0 | 2,281 | -193 | 1,315 | 0 | 1,315 | -1,160 |
| 2421 | Aerial Cable - Metallic | 145,482 | 18,331 | 0 | 18,331 | 6,401 | 0 | 6,401 | -11,929 | 3,783 | 0 | 3,783 | -14,548 |
| 2421 | Aerial Cable - Non Metallic | 6,840 | 595 | 0 | 595 | 650 | 0 | 650 | 55 | 233 | 0 | 233 | -363 |
| 2422 | Underground Cable - Metallic | 284,540 | 27,031 | 0 | 27,031 | 11,951 | 0 | 11,951 | -15,081 | 9,959 | 0 | 9,959 | -17,072 |
| 2422 | Underground Cable - Non Metallic | 133,505 | 13,751 | 0 | 13,751 | 11,081 | 0 | 11,081 | -2,670 | 3,605 | 0 | 3,605 | -10,146 |
| 2423 | Buried Cable - Metallic | 1,194,457 | 143,335 | 0 | 143,335 | 77,640 | 0 | 77,640 | -65,695 | 38,223 | 0 | 38,223 | -105,112 |
| 2423 | Buried Cable - Non Metallic | 17,322 | 1,109 | 0 | 1,109 | 1,143 | 0 | 1,143 | 35 | 520 | 0 | 520 | -589 |
| 2424 | Submarine Cable - Metallic | 2 | 2 | 0 | 2 | 0 | 0 | 0 | -2 | 0 | 0 | 0 | -2 |
| 2424 | Submarine Cable - Non Metallic | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 2426 | Intrabuilding Cable - Metallic | 31,784 | 1,112 | 0 | 1,112 | 954 | 0 | 954 | -159 | 763 | 0 | 763 | -350 |
| 2426 | Intrabuilding Cable - Non Metallic | 773 | 101 | 0 | 101 | 49 | 0 | 49 | -53 | 21 | 0 | 21 | -80 |
| 2431 | Aerial Wire | 8,069 | 1,662 | 0 | 1,662 | 605 | 0 | 605 | -1,057 | 395 | 0 | 395 | -1,267 |
| 2441 | Conduit Systems | 330,286 | 7,266 | 0 | 7,266 | 7,266 | 0 | 7,266 | 0 | 7,266 | 0 | 7,266 | 0 |
| | TOTAL | 4,600,342 | 447,728 | 0 | 447,728 | 285,035 | 0 | 285,035 | -162,693 | 198,154 | 0 | 198,154 | -249,574 |
| | | | | | 9.7% | | | 6.2% | | | | 4.3% | |

**STATEMENT C**
**INTRASTATE BASIS**
**SUMMARY OF RESERVES 1-1-2004**

| | | | | | Update Reserve to 12/31/03 | | | | | | Adjust Lives and Salvage Parameters | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Account Number | Category | Investment 1/1/04 | Book Reserve Amount | Book Reserve Percent | Average Service Life | Average Remaining Life | Average Net Salvage | Future Net Salvage | Theoretical Reserve Amount | Theoretical Reserve Percent | Average Service Life | Average Remaining Life | Average Net Salvage | Future Net Salvage | Theoretical Reserve Amount | Theoretical Reserve Percent |
| | | A | B | C=B/A | D | E | F | G | H | I | J | K | L | M | N | O |
| 2112 | Motor Vehicles | 50,002,464 | 28,870,369 | 57.7% | 9.2 | 3.8 | 15.4% | 16.0% | 24,529,470 | 49.1% | 9.2 | 3.8 | 15.4% | 16.0% | 24,529,470 | 49.1% |
| 2114 | Special Pupose Vehicles | 18,258 | 8,024 | 43.9% | 14.9 | 4.4 | 0.0% | 0.0% | 12,866 | 70.5% | 14.9 | 4.4 | 0.0% | 0.0% | 12,866 | 70.5% |
| 2115 | Garage Work Equipment | 1,074,994 | -184,705 | -17.2% | 13.6 | 9.1 | -24.0% | -4.0% | 226,065 | 21.0% | 13.6 | 9.1 | -24.0% | -4.0% | 226,065 | 21.0% |
| 2116 | Other Work Equipment | 27,123,901 | 12,101,709 | 44.6% | 10.8 | 6.7 | 9.0% | 7.0% | 9,912,781 | 36.5% | 10.8 | 6.7 | 9.0% | 7.0% | 9,912,781 | 36.5% |
| 2121 | Buildings | 168,555,110 | 46,482,803 | 27.6% | 34.0 | 24.0 | 2.0% | -6.0% | 62,067,941 | 36.8% | 34.0 | 24.0 | 2.0% | -6.0% | 62,067,941 | 36.8% |
| 2122 | Furniture | 1,253,232 | 910,003 | 72.6% | 13.4 | 6.8 | 3.0% | 0.0% | 636,343 | 50.8% | 13.4 | 6.8 | 3.0% | 0.0% | 636,343 | 50.8% |
| 2123.1 | Office Equipment | 4,185,608 | 4,287,951 | 102.4% | 12.5 | 2.5 | 0.0% | 0.0% | 3,348,486 | 80.0% | 12.5 | 2.5 | 0.0% | 0.0% | 3,348,486 | 80.0% |
| 2123.2 | Company Communications Equipment | 1,719,023 | 1,586,731 | 92.3% | 10.2 | 4.6 | -0.1% | 0.0% | 943,002 | 54.9% | 10.2 | 4.6 | -0.1% | 0.0% | 943,002 | 54.9% |
| 2124 | General Purpose Computer | 68,171,220 | 65,345,000 | 95.9% | 8.7 | 1.7 | 6.0% | 5.0% | 52,241,095 | 76.6% | 8.7 | 1.7 | 6.0% | 5.0% | 52,241,095 | 76.6% |
| 2212 | Digital Switching Equipment | 899,492,511 | 493,905,660 | 54.9% | 11.0 | 5.2 | 3.0% | 3.0% | 460,049,533 | 51.1% | 14.2 | 8.3 | -2.1% | 0.0% | 362,691,850 | 40.3% |
| 2220 | Operator Systems | 1,962,173 | 100,607 | 5.1% | 12.0 | 3.8 | -3.0% | -3.0% | 1,381,043 | 70.4% | 12.0 | 3.8 | -1.3% | -3.0% | 1,391,606 | 70.9% |
| 2231 | Radio Systems | 20,997,530 | 20,642,508 | 98.3% | 17.6 | 5.0 | -1.0% | -2.0% | 15,392,621 | 73.3% | 17.6 | 5.0 | -2.1% | -2.0% | 15,327,004 | 73.0% |
| 2232 | Circuit DDS | 3,516,888 | 3,171,205 | 90.2% | 10.4 | 3.4 | 8.0% | 3.0% | 2,353,610 | 66.9% | 11.0 | 3.9 | 0.8% | 0.0% | 2,279,967 | 64.8% |
| 2232 | Circuit Digital | 1,084,181,775 | 657,468,596 | 60.6% | 10.7 | 5.3 | 2.0% | 2.0% | 536,214,014 | 49.5% | 11.8 | 6.3 | -2.1% | 0.0% | 493,183,264 | 45.5% |
| 2232 | Circuit Analog | 25,342,409 | 25,674,921 | 101.3% | 14.7 | 2.8 | -1.0% | 0.0% | 20,467,012 | 80.8% | 15.5 | 3.6 | 1.2% | 0.0% | 19,527,062 | 77.1% |
| 2362 | Other Terminal Equipment | 51,022,353 | 28,796,299 | 56.4% | 11.1 | 6.5 | 8.0% | 2.0% | 22,514,188 | 44.1% | 11.1 | 6.5 | 8.0% | 2.0% | 22,514,188 | 44.1% |
| 2411 | Pole Lines | 38,664,356 | 34,911,771 | 90.3% | 35.0 | 25.0 | -86.0% | -138.0% | 40,652,809 | 105.1% | 35.3 | 24.7 | -72.4% | -75.0% | 21,021,361 | 54.4% |
| 2421 | Aerial Cable - Metallic | 145,481,570 | 152,605,742 | 104.9% | 14.5 | 5.0 | -21.0% | -27.0% | 124,060,663 | 85.3% | 21.9 | 11.4 | -35.7% | -35.0% | 93,634,330 | 64.4% |
| 2421 | Aerial Cable - Non Metallic | 6,839,635 | 3,012,601 | 44.0% | 15.0 | 8.7 | -27.0% | -27.0% | 3,648,261 | 53.3% | 28.0 | 21.7 | -6.8% | -17.5% | 2,375,405 | 34.7% |
| 2422 | Underground Cable - Metallic | 284,539,853 | 236,393,171 | 83.1% | 19.4 | 5.5 | -6.0% | -6.0% | 216,103,618 | 75.9% | 28.4 | 13.3 | -41.4% | -30.0% | 181,482,324 | 63.8% |
| 2422 | Underground Cable - Non Metallic | 133,504,518 | 66,293,221 | 49.7% | 13.4 | 6.8 | -6.0% | -6.0% | 69,701,314 | 52.2% | 28.0 | 21.1 | 4.2% | -6.0% | 45,135,017 | 33.8% |
| 2423 | Buried Cable - Metallic | 1,194,457,308 | 855,895,237 | 71.7% | 14.0 | 5.4 | -7.0% | -7.0% | 785,099,725 | 65.7% | 21.6 | 12.0 | -22.2% | -10.0% | 502,999,244 | 42.1% |
| 2423 | Buried Cable - Non Metallic | 17,321,629 | 8,542,486 | 49.3% | 18.0 | 8.7 | -7.0% | -7.0% | 9,575,974 | 55.3% | 28.0 | 18.6 | 10.9% | -5.0% | 7,935,409 | 45.8% |
| 2424 | Submarine Cable - Metallic | 1,887 | 2,294 | 121.6% | 22.0 | 0.5 | 0.0% | 0.0% | 1,844 | 97.7% | 22.0 | 0.5 | -1.2% | -1.0% | 1,862 | 98.7% |
| 2424 | Submarine Cable - Non Metallic | 0 | 0 | 0.0% | 0.0 | 0.0 | 0.0% | 0.0% | 0 | 0.0% | 0.0 | 0.0 | 0.0% | 0.0% | 0 | 0.0% |
| 2426 | Intrabuilding Cable - Metallic | 31,784,356 | 24,404,951 | 76.8% | 22.0 | 7.7 | 2.0% | 0.0% | 20,882,322 | 65.7% | 23.7 | 9.5 | 6.8% | 0.0% | 19,910,150 | 62.6% |
| 2426 | Intrabuilding Cable - Non Metallic | 773,315 | 473,231 | 61.2% | 10.5 | 6.2 | 0.0% | 0.0% | 316,691 | 41.0% | 19.1 | 14.6 | 7.1% | 0.0% | 224,164 | 29.0% |
| 2431 | Aerial Wire | 8,068,659 | 7,303,094 | 90.5% | 11.2 | 5.3 | -25.0% | -30.0% | 5,716,501 | 70.8% | 15.2 | 10.2 | -38.0% | -40.0% | 3,824,120 | 47.4% |
| 2441 | Conduit Systems | 330,285,891 | 78,455,729 | 23.8% | 57.0 | 43.0 | -20.0% | -20.0% | 97,347,421 | 29.5% | 57.0 | 42.9 | -23.8% | -20.0% | 88,596,583 | 26.8% |
| | Total | 4,600,342,426 | 2,857,461,209 | 62.1% | | | | | 2,585,397,212 | 56.2% | | | | | 2,037,972,957 | 44.3% |

## PARAMETER REPORT

| Account Number | Category | First ELG Year | Current Prescribed: P.L. or AYFR | Current Prescribed: Average Net Salvage | Current Prescribed: Future Net Salvage | Current Prescribed: Iowa Curve Shape | Staff Recommendation: P.L. or AYFR | Staff Recommendation: Average Net Salvage | Staff Recommendation: Future Net Salvage | Staff Recommendation: Iowa Curve Shape |
|---|---|---|---|---|---|---|---|---|---|---|
| | | A | B | C | D | E | F | G | H | I |
| 2112 | Motor Vehicles | 1983 | 8.6 | 15.4% | 16.0% | L3.0 | 8.6 | 15.4% | 16.0% | L3.0 |
| 2114 | Special Pupose Vehicles | | 16.1 | 0.0% | 0.0% | S6.0 | 16.1 | 0.0% | 0.0% | S6.0 |
| 2115 | Garage Work Equipment | | 13.7 | -24.0% | -4.0% | L0.0 | 13.7 | -24.0% | -4.0% | L0.0 |
| 2116 | Other Work Equipment | | 11.5 | 9.0% | 7.0% | L4.0 | 11.5 | 9.0% | 7.0% | L4.0 |
| 2121 | Buildings | 1983 | 43.0 | 2.0% | -6.0% | R1.0 | 43.0 | 2.0% | -6.0% | R1.0 |
| 2122 | Furniture | 1983 | 9.5 | 3.0% | 0.0% | O4.0 | 9.5 | 3.0% | 0.0% | O4.0 |
| 2123.1 | Office Equipment | 1983 | 7.0 | 0.0% | 0.0% | L0.5 | 7.0 | 0.0% | 0.0% | L0.5 |
| 2123.2 | Company Communications Equipment | | 8.3 | -0.1% | 0.0% | L0.5 | 8.3 | -0.1% | 0.0% | L0.5 |
| 2124 | General Purpose Computer | 1983 | 5.0 | 6.0% | 5.0% | O1.0 | 5.0 | 6.0% | 5.0% | O1.0 |
| 2212 | Digital Switching Equipment | 1983 | 10.0 | 3.0% | 3.0% | O1.0 | 15.0 | -2.1% | 0.0% | O1.0 |
| 2220 | Operator Systems | 1983 | 10.7 | -3.0% | -3.0% | S2.0 | 8.0 | -1.3% | -3.0% | S2.0 |
| 2231 | Radio Systems | 1983 | 15.1 | -1.0% | -2.0% | S1.5 | 15.1 | -2.1% | -2.0% | S1.5 |
| 2232 | Circuit DDS | 1983 | 8.1 | 8.0% | 3.0% | L1.0 | 9.0 | 0.8% | 0.0% | L1.0 |
| 2232 | Circuit Digital | 1983 | 10.0 | 2.0% | 2.0% | O2.0 | 12.0 | -2.1% | 0.0% | O2.0 |
| 2232 | Circuit Analog | 1983 | 8.0 | -1.0% | 0.0% | L0.0 | 9.5 | 1.2% | 0.0% | L0.0 |
| 2362 | Other Terminal Equipment | | 6.8 | 8.0% | 2.0% | O3.0 | 6.8 | 8.0% | 2.0% | O3.0 |
| 2411 | Pole Lines | 1982 | 46.4 | -86.0% | -138.0% | O1.0 | 46.4 | -72.4% | -75.0% | O1.0 |
| 2421 | Aerial Cable - Metallic | 1982 | 12.0 | -21.0% | -27.0% | R1.0 | 23.0 | -35.7% | -35.0% | R1.0 |
| 2421 | Aerial Cable - Non Metallic | 1982 | 14.5 | -27.0% | -27.0% | SQ | 27.5 | -6.8% | -17.5% | SQ |
| 2422 | Underground Cable - Metallic | 1982 | 15.0 | -6.0% | -6.0% | R1.5 | 27.5 | -41.4% | -30.0% | R1.5 |
| 2422 | Underground Cable - Non Metallic | 1982 | 13.1 | -6.0% | -6.0% | SQ | 27.5 | 4.2% | -6.0% | SQ |
| 2423 | Buried Cable - Metallic | 1982 | 12.0 | -7.0% | -7.0% | L1.5 | 23.0 | -22.2% | -10.0% | L1.5 |
| 2423 | Buried Cable - Non Metallic | 1982 | 17.6 | -7.0% | -7.0% | SQ | 27.5 | 10.9% | -5.0% | SQ |
| 2424 | Submarine Cable - Metallic | 1982 | 15.0 | 0.0% | 0.0% | SQ | 23.0 | -1.2% | -1.0% | SQ |
| 2424 | Submarine Cable - Non Metallic | 1982 | 9.0 | 0.0% | 0.0% | SQ | 27.5 | 0.0% | 0.0% | SQ |
| 2426 | Intrabuilding Cable - Metallic | 1982 | 19.0 | 2.0% | 0.0% | L2.0 | 22.5 | 6.8% | 0.0% | L2.0 |
| 2426 | Intrabuilding Cable - Non Metallic | 1982 | 11.5 | 0.0% | 0.0% | O1.0 | 27.5 | 7.1% | 0.0% | O1.0 |
| 2431 | Aerial Wire | | 8.9 | -25.0% | -30.0% | L0.0 | 15.0 | -38.0% | -40.0% | L0.0 |
| 2441 | Conduit Systems | 1982 | 56.6 | -20.0% | -20.0% | SQ | 56.6 | -23.8% | -20.0% | SQ |

## SUMMARY OF STAFF'S RECOMMENDED LIVES

| Account Number | Category | FCC Projection Life Range (Years) Low | High | Recent Observed Lives | Current Prescribed Lives | Staff Recommended Lives | FCC Future Net Salvage Range (Percent) Low | High | Surviving Vintage Average Net Salvage | Recent Observed Average Net Salvage | Current Prescribed Future Net Salvage | Staff Recommended Future Net Salvage |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | A | B | C | D | E | F | G | H | I | J | K |
| 2112 | Motor Vehicles | 7.5 | 9.5 | | 8.6 | 8.6 | 10% | 20% | | | 16.0% | 16.0% |
| 2114 | Special Pupose Vehicles | 12.0 | 18.0 | | 16.1 | 16.1 | 0% | 10% | | | 0.0% | 0.0% |
| 2115 | Garage Work Equipment | 12.0 | 18.0 | | 13.7 | 13.7 | 0% | 10% | | | -4.0% | -4.0% |
| 2116 | Other Work Equipment | 12.0 | 18.0 | | 11.5 | 11.5 | 0% | 10% | | | 7.0% | 7.0% |
| 2121 | Buildings | | | | 43.0 | 43.0 | | | | | -6.0% | -6.0% |
| 2122 | Furniture | 15.0 | 20.0 | | 9.5 | 9.5 | 0% | 10% | | | 0.0% | 0.0% |
| 2123.1 | Office Equipment | 10.0 | 15.0 | | 7.0 | 7.0 | 0% | 10% | | | 0.0% | 0.0% |
| 2123.2 | Company Communications Equipment | 7.0 | 10.0 | | 8.3 | 8.3 | -5% | 10% | | | 0.0% | 0.0% |
| 2124 | General Purpose Computer | 6.0 | 8.0 | | 5.0 | 5.0 | 0% | 5% | | | 5.0% | 5.0% |
| 2212 | Digital Switching Equipment | 12.0 | 18.0 | 29.0 | 10.0 | 15.0 | 0% | 5% | -2.1% | -3.9% | 3.0% | 0.0% |
| 2220 | Operator Systems | 8.0 | 12.0 | 7.6 | 10.7 | 8.0 | 0% | 5% | -1.3% | -2.0% | -3.0% | -3.0% |
| 2231 | Radio Systems | 9.0 | 15.0 | 17.0 | 15.1 | 15.1 | -5% | 5% | -2.1% | -2.7% | -2.0% | -2.0% |
| 2232 | Circuit DDS | 7.0 | 11.0 | 16.6 | 8.1 | 9.0 | -5% | 10% | 0.8% | -1.6% | 3.0% | 0.0% |
| 2232 | Circuit Digital | 11.0 | 13.0 | 28.2 | 10.0 | 12.0 | 0% | 5% | -2.1% | -6.6% | 2.0% | 0.0% |
| 2232 | Circuit Analog | 8.0 | 11.0 | 20.6 | 8.0 | 9.5 | -5% | 0% | 1.2% | 2.5% | 0.0% | 0.0% |
| 2362 | Other Terminal Equipment | 5.0 | 8.0 | | 6.8 | 6.8 | -5% | 5% | | | 2.0% | 2.0% |
| 2411 | Pole Lines | 25.0 | 35.0 | 63.1 | 46.4 | 46.4 | -75% | -50% | -72.4% | -87.2% | -138.0% | -75.0% |
| 2421 | Aerial Cable - Metallic | 20.0 | 26.0 | 41.1 | 12.0 | 23.0 | -35% | -10% | -35.7% | -67.2% | -27.0% | -35.0% |
| 2421 | Aerial Cable - Non Metallic | 25.0 | 30.0 | 41.1 | 14.5 | 27.5 | -25% | -10% | -6.8% | -9.3% | -27.0% | -17.5% |
| 2422 | Underground Cable - Metallic | 25.0 | 30.0 | 64.0 | 15.0 | 27.5 | -30% | -5% | -41.4% | -74.5% | -6.0% | -30.0% |
| 2422 | Underground Cable - Non Metallic | 25.0 | 30.0 | 64.0 | 13.1 | 27.5 | -20% | -5% | 4.2% | 4.6% | -6.0% | -6.0% |
| 2423 | Buried Cable - Metallic | 20.0 | 26.0 | 58.8 | 12.0 | 23.0 | -10% | 0% | -22.2% | -34.7% | -7.0% | -10.0% |
| 2423 | Buried Cable - Non Metallic | 25.0 | 30.0 | 58.8 | 17.6 | 27.5 | -10% | 0% | 10.9% | 20.1% | -7.0% | -5.0% |
| 2424 | Submarine Cable - Metallic | 25.0 | 30.0 | 23.0 | 15.0 | 23.0 | -5% | 0% | -1.2% | 0.0% | 0.0% | -1.0% |
| 2424 | Submarine Cable - Non Metallic | 25.0 | 30.0 | 23.0 | 9.0 | 27.5 | -5% | 0% | 0.0% | 0.0% | 0.0% | 0.0% |
| 2426 | Intrabuilding Cable - Metallic | 20.0 | 25.0 | 67.0 | 19.0 | 22.5 | -30% | -5% | 6.8% | 8.1% | 0.0% | 0.0% |
| 2426 | Intrabuilding Cable - Non Metallic | 25.0 | 30.0 | 67.0 | 11.5 | 27.5 | -15% | 0% | 7.1% | 20.5% | 0.0% | 0.0% |
| 2431 | Aerial Wire | | | | 8.9 | 15.0 | | | -38.0% | -56.9% | -30.0% | -40.0% |
| 2441 | Conduit Systems | 50.0 | 60.0 | 77.2 | 56.6 | 56.6 | -10% | 0% | -23.8% | -20.1% | -20.0% | -20.0% |

Sources:
FCC Ranges from FCC 94-174, Released June 28, 1994, Appendix B, FCC 95-181, Released May 4, 1995, Appendix B, and FCC 99-397, Released December 30, 1999, Appendix B.
Recent Observed Lives from Attachment A of Qwest's response to WDA 02-06
Recent Observed Net Salvages from Attachment A of Qwest's response to WDA 01-05

Arizona
T-01051B-03-0454
Dunkel 01-005

INTERVENOR: Dunkel and Associates

REQUEST NO: 005

For each depreciable account, provide the Gross Salvage and Cost of Removal data for the years 1983 through 2003. This should be information similar to that provided on "Table A, Annual Retirements, Gross Salvage and Cost of Removal" included in the Qwest Supplement to Application filed November 12, 1997 in the prior Depreciation Case (Docket No T-1051B-97-0689), excepted using the more current data (20 years through 2003). For each year the information should at include, but not necessarily limited to, the plant in service, the plant retired, the gross salvage, and the cost of removal. Provide in electronic format (in the same electronic format as this information is provided to the FCC) on an IBM compatible 3.5" disk or CD and in paper format.

RESPONSE:

See Non-confidential Attachments "A" and "B" for the requested information.

Respondent: Jim Jones, Qwest Manager

06/04/04
09:41 AM
XREF: 09
PRES: 1997,SF,02
PROP: 2004,SA,02

COMPANY: QWEST CORPORATION
STATE: ARIZONA
ACCOUNT: 2411 POLE LINES
CATEGORY: 2411 POLE LINES
PAGE 1 OF 1

TABLE A
ANNUAL RETIREMENTS
GROSS SALVAGE AND COST OF REMOVAL

TOTAL RETIREMENTS

| YEAR | PLANT IN SERVICE DEC. 31 | PLANT RETIRED* | GROSS AMOUNT | SALVAGE* PERCENT | COST OF AMOUNT | REMOVAL* PERCENT | NET SALVAGE PERCENT |
|---|---|---|---|---|---|---|---|
| | A | B | C | D=(C/B) *100 | E | F=(E/B) *100 | G=(D-F) |
| 1983 | 27,890,000 | 890,152 | 28,032 | 3.1 | 383,664 | 43.1 | -40.0 |
| 1984 | 28,599,000 | 428,132 | 93,532 | 21.8 | 449,039 | 104.9 | -83.1 |
| 1985 | 29,519,000 | 312,530 | 31,420 | 10.1 | 256,335 | 82.0 | -71.9 |
| 1986 | 30,486,000 | 565,825 | 25,165 | 4.4 | 266,672 | 47.1 | -42.7 |
| 1987 | 30,737,923 | 871,433 | 7,151 | 0.8 | 255,243 | 29.3 | -28.5 |
| 1988 | 32,498,505 | 362,720 | 4,452 | 1.2 | 213,297 | 58.8 | -57.6 |
| 1989 | 33,668,265 | 595,511 | 27,578 | 4.6 | 291,369 | 48.9 | -44.3 |
| 1990 | 34,825,124 | 709,526 | 4,083 | 0.6 | 350,674 | 49.4 | -48.8 |
| 1991 | 36,463,035 | 106,275 | -263 | -0.2 | 354,151 | 333.2 | -333.4 |
| 1992 | 38,334,023 | 82,018 | 0 | 0.0 | 317,435 | 387.0 | -387.0 |
| 1993 | 40,374,609 | 247,168 | 0 | 0.0 | 440,542 | 178.2 | -178.2 |
| 1994 | 41,751,738 | 230,013 | 0 | 0.0 | 251,018 | 109.1 | -109.1 |
| 1995 | 41,938,944 | 182,121 | 1,932 | 1.1 | 285,681 | 156.9 | -155.8 |
| 1996 | 42,410,540 | 329,930 | 6,776 | 2.1 | 196,170 | 59.5 | -57.4 |
| 1997 | 43,818,511 | 499,151 | 5,006 | 1.0 | 203,868 | 40.8 | -39.8 |
| 1998 | 45,034,213 | 354,440 | 5,096 | 1.4 | 150,162 | 42.4 | -41.0 |
| 1999 | 46,616,809 | 149,852 | 1,340 | 0.9 | 116,947 | 78.0 | -77.1 |
| 2000 | 48,178,092 | 104,870 | 2,422 | 2.3 | 167,057 | 159.3 | -157.0 |
| 2001 | 49,844,594 | 116,994 | 1,201 | 1.0 | 174,026 | 148.7 | -147.7 |
| 2002 | 51,293,484 | 310,853 | 649 | 0.2 | 1,256,896 | 404.3 | -404.1 |
| 2003 | 52,703,590 | 308,799 | 3,733 | 1.2 | -517,860 | -167.7 | 168.9 |
| GRAND TOTAL | | 7,758,313 | 249,305 | 3.2 | 5,862,386 | 75.6 | -72.4 |
| 1983-2003# | | 7,758,313 | 249,305 | 3.2 | 5,862,386 | 75.6 | -72.4 |
| 1994-2003## | | 2,587,023 | 28,155 | 1.1 | 2,283,965 | 88.3 | -87.2 |

\# REPRESENTS RETIREMENTS FROM SURVIVING VINTAGES.
\## BAND OF LAST 10 ACTIVITY YEARS.
* EXCLUDING SALES & TRANSACTIONS THAT WERE EXCLUDED FROM LIFE DETERMINATION.

Arizona
T-01051B-03-0454 and T-00000D-00-0672
WDA 04-032

INTERVENOR: William W. Dunkel and Associates

REQUEST NO: 032

RE: DSL

Please provide the following:

a. A complete description of the Company's DSL service, including the type of DSL service, the tariff under which the service is offered, and a diagram of the network configuration of the Company's DSL offering.

b. The amount of DSL investment by account/subaccount(s) where such investment is recorded.

c. Description of the equipment contained in the investment included in response to part (b).

d. The amount of DSL related reserves and expenses by account/subaccount(s) where such expenses and reserves are recorded.

e. Separately show the amounts of DSL costs provided in response to parts (b) and (d) above which are included in the Company's test year regulated operations.

f. The separations category in which the DSL investment is included in the Company's Part 36 Cost Study, and the percentage of this DSL investment which is allocated to the intrastate jurisdiction in the Company's Part 36 Cost Study.

g. Is it the Company's understanding the DSL service is used primarily for Internet access? If not, please explain.

h. As of 12-31-03 please provide the number of lines in which the Company provided DSL service over the same loop that local service is provided, that is the number of loops in which DSL shares the line with local service.

i. As of 12-31-03 please provide the number of lines in which the Company provided DSL service over a separate loop, which is the number of lines in which DSL does not share the loop with any other service.

RESPONSE:

a. See Non-Confidential Attachment A for a complete technical description, including diagrams, of Qwest's DSL service. Qwest offers its DSL service under its FCC Tariff # 1, Section 8.4.

b. Direct incremental DSL investment by Field Reporting Code (FRC) is identified in Confidential Attachment B to this response

c. Please see the Company's response to UTI Set 2, Request 001 for a description of equipment included within each FRC.

d. Please see the response to part (b) above for the related depreciation reserves associated with the investment. The Company does not separately track and is unable to identify separate expenses associated with this or any other product. The Company's expenses are identified as required by Part 32 of the FCC's rules and regulations.

e. The Company's costs are separated between the interstate and intrastate jurisdictions as required by Part 36 of the FCC's rules and regulations. No special separations studies have been created for DSL services or any other regulated products.

f. The separations categories for each Part 32 account identified in Parts b and d of this response are determined based on Part 36 rules and regulations. Please see the Company's response to WDA, Set 02, Request 020 in this docket.

g. Yes.

h. Please see the response provided to RUCO, Set 02, Request 046 in this docket.

i. Zero

Respondents: Parts a, g, h and i: Maryann Klasinski, Michael Wolz, Reed Peterson
Respondents: Parts b, c, d, e and f: Mike Hudson, Don Hunsaker and Deb Hayek

THIS SCHEDULE CONTAINS INFORMATION DESIGNATED AS CONFIDENTIAL BY QWEST AND HAS BEEN REDACTED FROM THIS PUBLIC FILING.

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AND HAS BEEN REDACTED FROM THIS
PUBLIC FILING.

# IMPACT OF REMOVING DSL INVESTMENT FROM INTRASTATE

**Impact on Rate Base**

| | | Plant in Service | Accumulated Depreciation | Net Investment |
|---|---|---|---|---|
| 1 | Total DSL Amounts from Qwest Response to WDA 4-32 | | | |
| 2 | Effective Intrastate Factor | | | |
| 3 | **Total Net Investment Removed from Intrastate Jurisdiction** | | | |

**Impact on Operating Expenses**

| | | |
|---|---|---|
| 4 | Removed Depreciation Expense related to DSL Investment | |
| 5 | Removed Maintenance Expense related to DSL Investment | |
| 6 | Remove Network Operations Expense Related to DSL Investment | |
| 7 | **Total Expenses Removed from Intrastate Jurisdiction** | |

Sources:
Intrastate Factors from Non-confidential Attachment A to Qwest Response to WDA 8-06

DSL Investment, Reserve, and Deprecation Expense from Confidential Attachment B to Qwest Response to WDA 4-32

Other Regulated Intrastate Amounts from Qwest file "az1203.xls", tab "TestYear Summary".

Before the
Federal Communications Commission
Washington, D.C. 20554

| | | |
|---|---|---|
| In the Matter of | ) | |
| | ) | |
| Jurisdictional Separations and Referral to the Federal-State Joint Board | ) | CC Docket No. 80-286 |
| | ) | |

## REPORT AND ORDER

Adopted: May 11, 2001 Released: May 22, 2001

By the Commission:

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Paragraph

**Before the
Federal Communications Commission
Washington, D.C. 20554**

| | | |
|---|---|---|
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| | ) | |

# REPORT AND ORDER

**Adopted: May 11, 2001** **Released: May 22, 2001**

By the Commission:

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Paragraph

Part 36, shall be frozen at their calendar year 2000 percentage ratios. Part 36 requires some categories of costs to be further sub-divided into additional classifications, but does not refer to those further classifications as "categories" or "subcategories." If we were to require carriers to continue subdividing costs into these classifications, carriers still would need to perform cost studies. Because a goal of the freeze is to reduce administrative burdens on carriers, we find that any Part 36 requirement to segregate costs recorded in Part 32 accounts into categories, subcategories, or further sub-classifications shall be frozen at their percentage relationship for the calendar year 2000.

23. Similarly, we find that in order to relieve all carriers of performing traffic or relative-use studies for separations purposes, all allocation factors used to assign Part 36 categories, subcategories, or further subdivisions to the state or interstate jurisdictions shall be frozen utilizing the factors calculated for the calendar year 2000. Categories or portions of categories that have been directly assigned in the past, however, will continue to be directly assigned to each jurisdiction. In other words, the frozen factors shall not have an effect on the direct assignment of costs for categories, or portions of categories, that are directly assigned. Since those portions of facilities that are utilized exclusively for services within the state or interstate jurisdiction are readily identifiable, we believe that the continuation of direct assignment of costs will not be a burden on carriers, nor will it adversely impact the stability of separations results throughout the freeze.[60]

24. Appendix A of the Recommended Decision provides the Joint Board's recommendation of the categories and factors to be frozen.[61] SBC, however, noted that Appendix A of the *Recommended Decision* failed to include Telephone Operator Expense and Published Directory Listing as frozen categories of Account 6620-Services.[62] Because these costs and relative use factors fall within the parameters of the freeze, we agree with SBC that it is appropriate to include these costs and their relative use factors in the freeze and therefore amend the list of categories and factors as specified in Appendix B of this Report and Order.

### 3. Base Year of the Freeze

25. The Joint Board recommended that, for all carriers, the Part 36 freeze should be based on data from the twelve-month period immediately prior to the date of the Commission's release of a Report and Order implementing the *Recommended Decision*.[63] The Joint Board believes that a freeze based on carriers' most recent data would provide the greatest measure of

[60] Examples of facilities in which a portion can be directly assigned include, Central Office Equipment- Category 2, Tandem switching equipment and Cable and Wire Facilities-Category 2, Wideband and exchange trunk. *See* 47 C.F.R. §§ 36.124 and 36.155.

[61] *Recommended Decision*, Appendix A, 15 FCC Rcd at 13181-83.

[62] *See* SBC Comments at 3-4. *See also*, 47 C.F.R. §§ 36.374-375.

[63] *Recommended Decision*, 15 FCC Rcd at 13174, para. 25.

## APPENDIX C

### Final Rules

Part 36 of Title 47 of the Code of Federal Regulations is amended as follows:

### PART 36 – JURISDICTIONAL SEPARATIONS PROCEDURES; STANDARD PROCEDURES FOR SEPARATING TELECOMMUNICATIONS PROPERTY COSTS, REVENUES, EXPENSES, TAXES AND RESERVES FOR TELECOMMUNICATIONS COMPANIES

### Subpart A – General

1. Section 36.3 is added as follows:

**§ 36.3 Freezing of jurisdictional separations category relationships and/or allocation factors**

(a) Effective July1, 2001, through June 30, 2006, all local exchange carriers subject to Part 36 rules shall apportion costs to the jurisdictions using their study area and/or exchange specific separations allocation factors calculated during the twelve month period ending December 31, 2000, for each of the categories/sub-categories as specified herein. Direct assignment of private line service costs between jurisdictions shall be updated annually. Other direct assignment of investment, expenses, revenues or taxes between jurisdictions shall be updated annually. Local exchange carriers that invest in telecommunications plant categories during the period July 1, 2001, through June 30, 2006, for which it had no separations allocation factors for the twelve month period ending December 31, 2000, shall apportion that investment among the jurisdictions in accordance with the separations procedures in effect as of December 31, 2000 for the duration of the freeze.

(b) Effective July 1, 2001, through June 30, 2006, local exchange carriers subject to price cap regulation, pursuant to § 61.41, shall assign costs from the Part 32 accounts to the separations categories/sub-categories, as specified herein, based on the percentage relationships of the categorized/sub-categorized costs to their associated Part 32 accounts for the twelve month period ending December 31, 2000. If a Part 32 account for separations purposes is categorized into more than one category, the percentage relationship among the categories shall be utilized as well. Local exchange carriers that invest in types of telecommunications plant during the period July 1, 2001, through June 30, 2006, for which it had no separations category investment for the twelve month period ending December 31, 2000, shall assign such investment to separations categories in accordance with the separations procedures in effect as of December 31, 2000.

(1) Local exchange carriers not subject to price cap regulation, pursuant to § 61.41, may elect to be subject to the provisions of § 36.3(b). Such election

# REPRODUCTION COST NEW LESS DEPRECIATION
## Staff Recommended Depreciation Parameters

| Account Number | Category | Condition Percent (% of Life Remaining) |
|---|---|---|
| 2112 | Motor Vehicles | 40.36% |
| 2114 | Special Pupose Vehicles | 27.06% |
| 2115 | Garage Work Equipment | 64.93% |
| 2116 | Other Work Equipment | 59.30% |
| 2121 | Buildings | 59.83% |
| 2122 | Furniture | 49.46% |
| 2123.1 | Office Equipment | 19.88% |
| 2123.2 | Company Communications Equipment | 43.80% |
| 2124 | General Purpose Computer | 25.81% |
| 2212 | Digital Switching Equipment | 62.14% |
| 2220 | Operator Systems | 30.99% |
| 2231 | Radio Systems | 27.60% |
| 2232 | Circuit DDS | 37.10% |
| 2232 | Circuit Digital | 55.05% |
| 2232 | Circuit Analog | 23.34% |
| 2362 | Other Terminal Equipment | 58.10% |
| 2411 | Pole Lines | 63.94% |
| 2421 | Aerial Cable - Metallic | 37.95% |
| 2421 | Aerial Cable - Non Metallic | 76.85% |
| 2422 | Underground Cable - Metallic | 34.18% |
| 2422 | Underground Cable - Non Metallic | 75.32% |
| 2423 | Buried Cable - Metallic | 47.94% |
| 2423 | Buried Cable - Non Metallic | 66.75% |
| 2424 | Submarine Cable - Metallic | 2.26% |
| 2424 | Submarine Cable - Non Metallic | 0.00% |
| 2426 | Intrabuilding Cable - Metallic | 26.78% |
| 2426 | Intrabuilding Cable - Non Metallic | 75.78% |
| 2431 | Aerial Wire | 62.60% |
| 2441 | Conduit Systems | 56.33% |

REDACTED

Schedule WDA-18


**IMPACT OF REMOVING INVESTMENT WHICH SHOULD HAVE BEEN COVERED BY BSI CONSTRUCTION CHARGES RELATED TO BSI REQUESTED FACILITIES**

**Total Impact on Rate Base**
**"Video-Only" USAMS**
**Installed after 3/2/99**

| | Intrastate Plant in Service | Intrastate Accumulated Reserve | Net Intrastate Plant in Service |
|---|---|---|---|
| USAM Equipment Average Investment per Sample Site | | | |
| Total Number of "video-only" USAM Sites installed post 3/2/99 | | | |
| **Total Impact on USAM Investment** | | | |
| Fiber Cable Average Investment per Sample Site | | | |
| Total Number of "video-only" USAM Sites installed post 3/2/99 | | | |
| **Total Impact on Fiber Cable Investment** | | | |
| Copper Cable Average Investment per Sample Site | | | |
| Total Number of "video-only" USAM Sites installed post 3/2/99 | | | |
| **Total Impact on Copper Cable Investment** | | | |
| **Overall Impact on Intrastate Rate Base** | | | |

Source:

**IMPACT OF REMOVING INVESTMENT WHICH SHOULD HAVE BEEN COVERED BY BSI CONSTRUCTION CHARGES RELATED TO BSI REQUESTED FACILITIES**

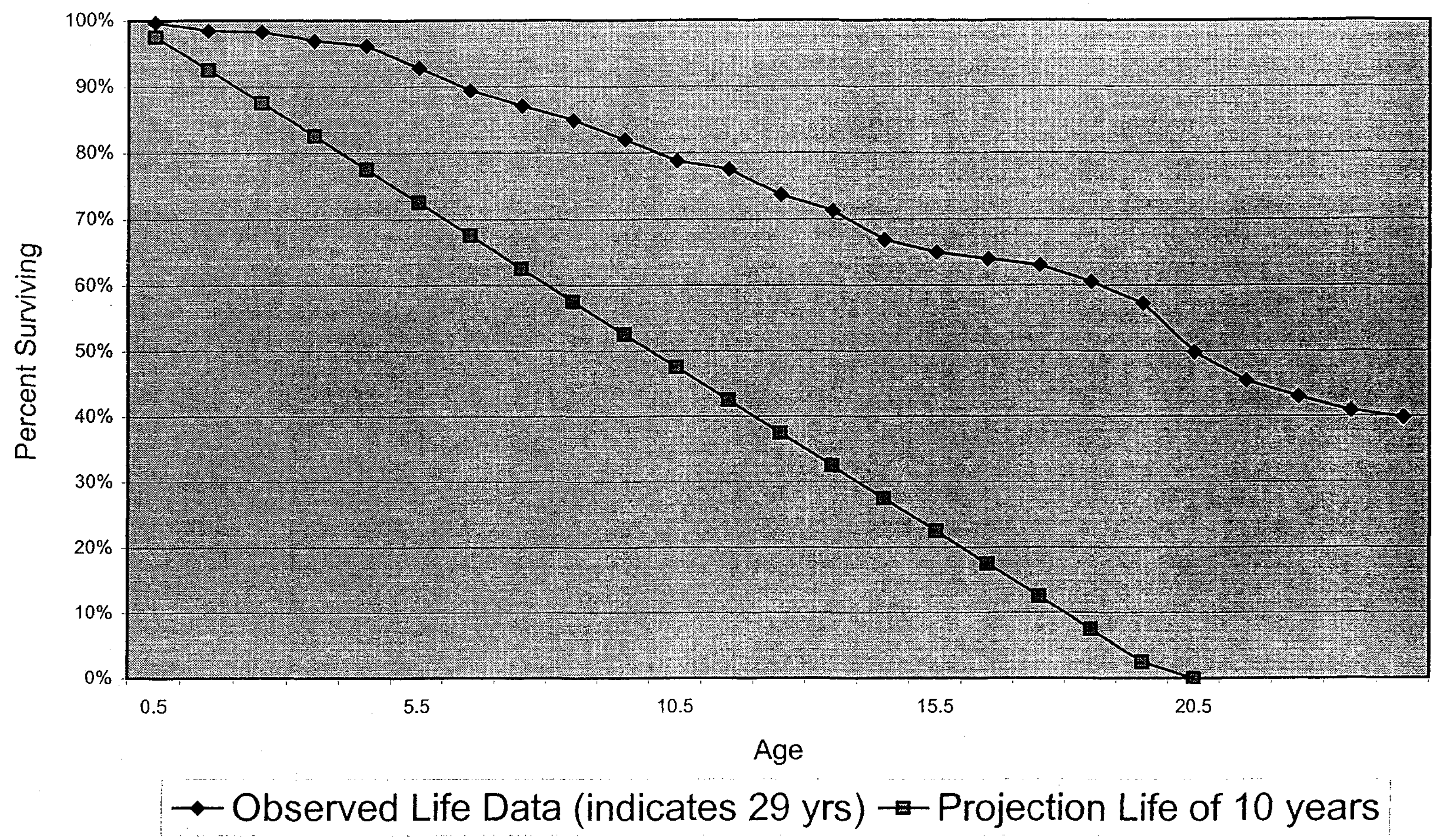
**Total Impact on Depreciation Expense**
**"Video-Only" USAMS**
**Installed after 3/2/99**

| | Average Intrastate Depreciation Expense per Sample | Total Number of "video-only" post 3/2/99 USAM Sites | Total Intrastate Depreciation Expense |
|---|---|---|---|
| Circuit Equipment | | | |
| Underground Cable - Copper | | | |
| Underground Cable - Fiber | | | |
| Buried Cable - Copper | | | |
| Buried Cable - Fiber | | | |
| **Overall Impact on Intrastate Depreciation Expense** | | | |

Source:
Qwest Confidential response to WDA 17-8
Qwest Confidential response to WDA 14-1
Qwest Confidential response to WDA 4-32

## Graph of Recent Observed Life Data and Qwest Projection Life

**Account 2212 - Digital Switching Equipment**

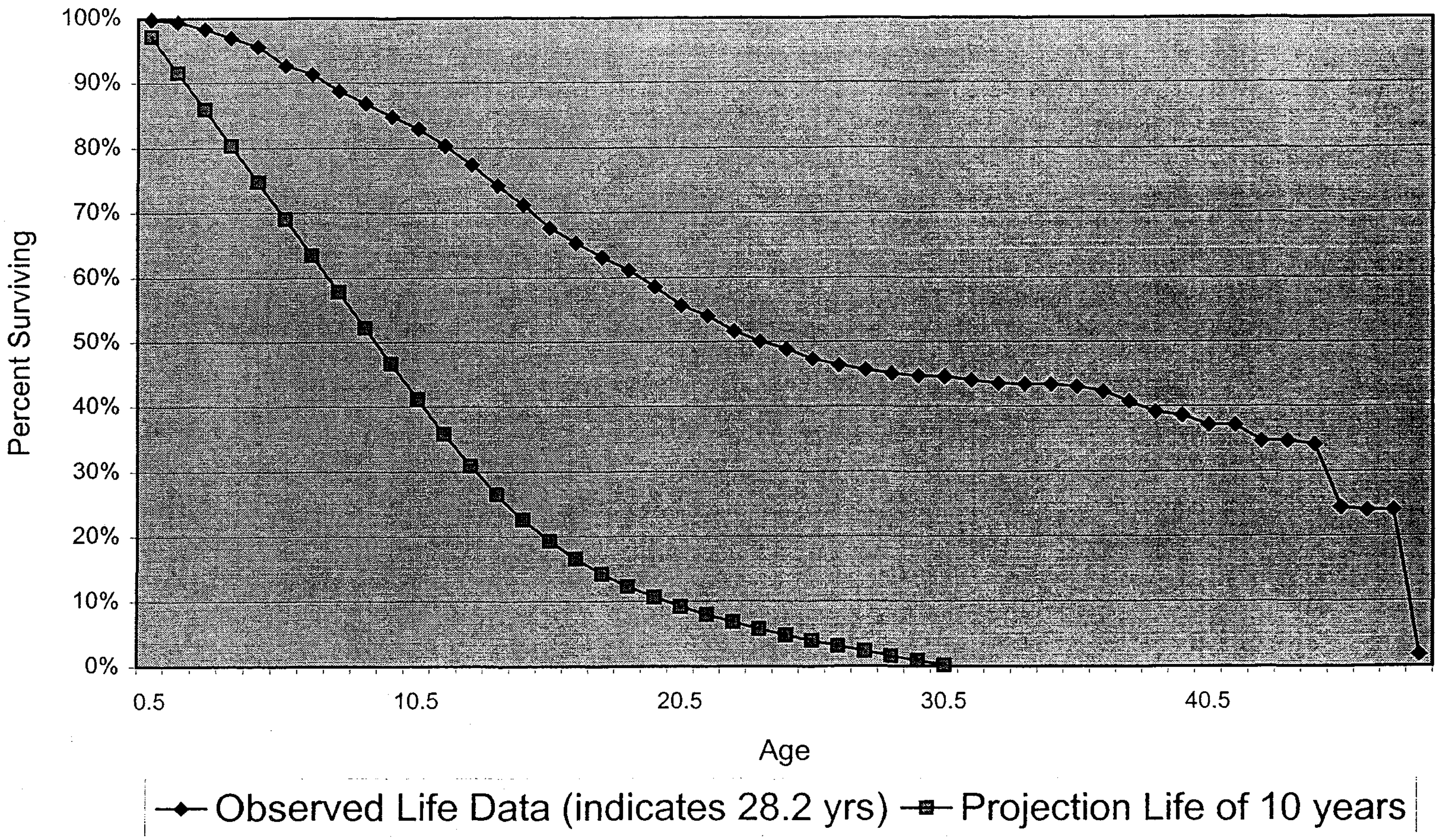



Source:
Observed Life from Qwest Responses to WDA 02-06 and WDA 04-02. (2001 - 2003 Band).
Projection Curve using Qwest's projection life of 10 years and O1.0 Iowa Curve

PUBLIC



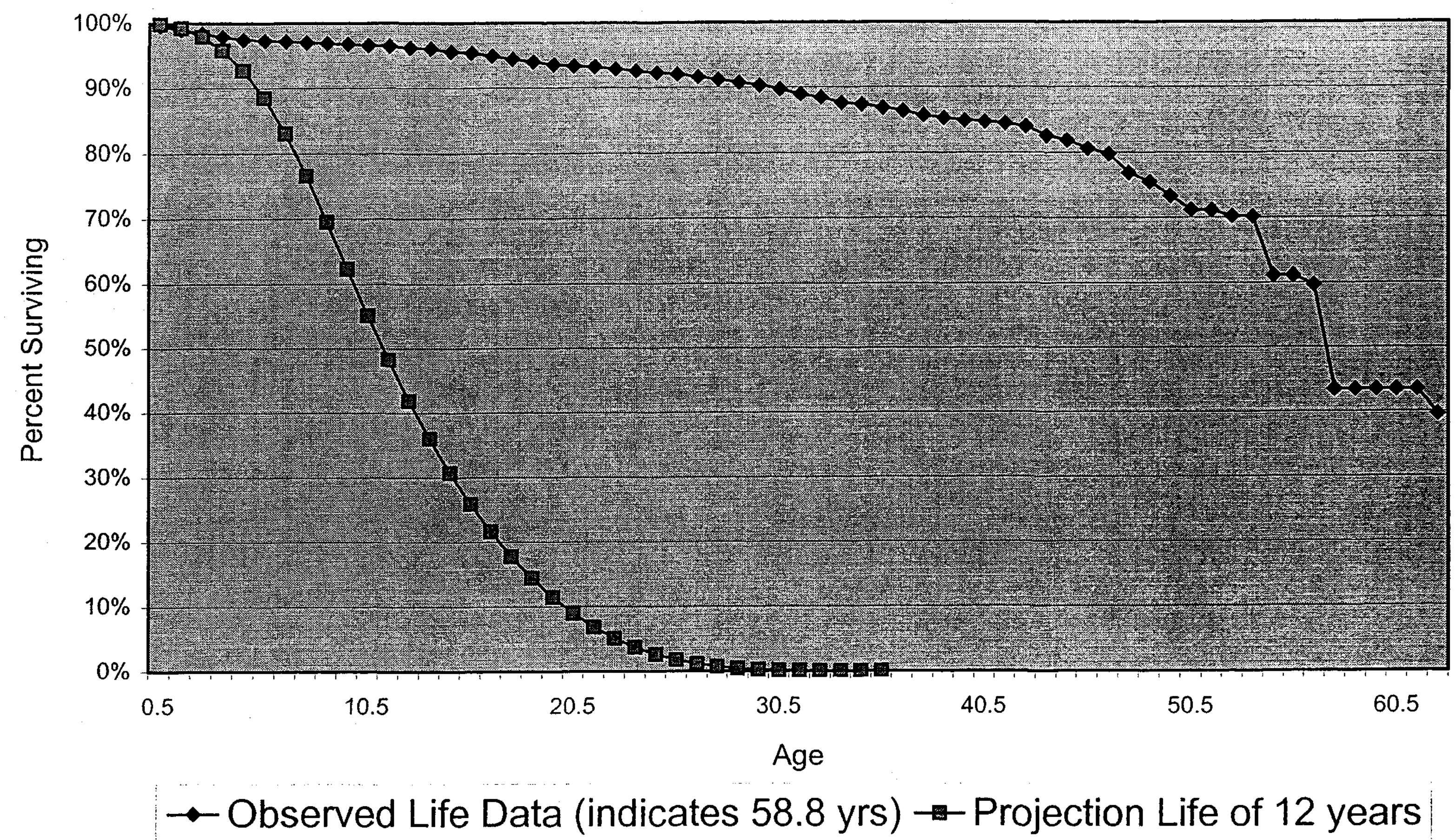
## Graph of Recent Observed Life Data and Qwest Projection Life
**Account 2232 - Circuit Digital Equipment**




Source:
Observed Life from Qwest Responses to WDA 02-06 and WDA 04-02. (2001 - 2003 Band).
*Projection Curve using* Qwest's projection life of 10 years and O2.0 Iowa Curve

## Graph of Recent Observed Life Data and Qwest Projection Life

**Account 2423 - Buried Cable - Metallic**




Source:

Observed Life from Qwest Responses to WDA 02-06 and WDA 04-02. (2001 - 2003 Band).

Projection Curve using Qwest's projection life of 12 years and L1.5 Iowa Curve